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Supreme Court, U.S.
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In The

Supreme Court of the United States

AMBASE CORPORATION,
A Delaware Corporation,

Petitioner,

v.

CITY INVESTING COMPANY LIQUIDATING TRUST, as successor to City Investing Company, a dissolved Delaware Corporation, JOHN J. QUIRK, Trustee of City Investing Company Liquidating Trust, MARION SCHARFFENBERGER, Executrix of the Estate of George T. Scharffenberger, EBEN W. PYNE, Individually and as Trustee of the City Investing Company Liquidating Trust, and LESTER J. MANTELL, Individually and as Trustee of the City Investing Company Liquidating Trust,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Petitioner respectfully submits that the Court of Appeals for the Second Circuit erroneously decided two important issues on which the circuits are divided:

1. Did the Second Circuit err by raising and upholding, sua sponte, the affirmative defense of res judicata notwithstanding that Respondents had expressly waived the defense in the trial court, the issue was not mentioned by the parties or the court in briefing or oral argument, and Petitioner was never accorded an opportunity to address it?

2. Did the Second Circuit contradict the Full Faith and Credit Act in holding that AmBase was precluded from arguing that it satisfied New York's six-year statute of limitations because a Delaware court had held that it failed to satisfy Delaware's three-year statute of limitations?

PARTIES TO THE PROCEEDING

The parties to the proceeding are set forth in the case caption.

CORPORATE DISCLOSURE STATEMENT

AmBase Corporation is a publicly held company that does not have a parent corporation, and no publicly held company owns 10% or more of the stock of the corporation.

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PETITION FOR A WRIT OF CERTIORARI

AmBase Corporation ("AmBase"), respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the Court of Appeals, as amended, is reported at 326 F.3d 63 (2d Cir. 2003), and is reprinted in the appendix hereto ("App.") at 1a. The relevant portions of the Court of Appeals unamended opinion are unpublished, and are reprinted at App. 66a. The Court of Appeals order denying rehearing and rehearing *en banc*, as modified, is reprinted at App. 57a. The unpublished decision of the district court is available at *AmBase Corp. v. City Investing Co. Liquidating Trust*, No. 01-Civ-0771, 2002 U.S. Dist. LEXIS 482 (S.D.N.Y. Jan. 11, 2002), and is reprinted at App. 25a. The decision of the Delaware Chancery Court in a related case is available at *AmBase Corp. v. City Investing Co.*, No. 18207, 2001 Del. Ch. LEXIS 16 (Feb. 7, 2001), and is reprinted at App. 38a. This written decision of the Delaware Chancery Court supplemented a prior oral ruling, which was reflected in a written order dismissing that case, which is reprinted at App. 55a.

JURISDICTION

Judgment of the Court of Appeals was entered on April 3, 2003, and modified on April 24, 2003; the Order denying rehearing and rehearing *en banc* was entered on June 12, 2003. This Court has jurisdiction under 28 U.S.C. § 1254.

PERTINENT CONSTITUTIONAL, STATUTORY, AND RULES PROVISIONS

This petition implicates a number of clauses of the Constitution of the United States. Section I implicates the Due Process Clause of the Fifth Amendment, which provides that "[n]o person shall . . . be deprived of life, liberty, or property, without due process of law." U.S. CONST. amend. V. Section II implicates the Full Faith & Credit Clause, which requires that "[f]ull faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state." U.S. CONST. art. IV, § 1.

Section I also implicates Federal Rules of Civil Procedure 8(c) and 12(b), which provide that:

> In pleading to a preceding pleading, a party shall set forth affirmatively accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver, and any other manner constituting an avoidance or affirmative defense.

FED. R. CIV. P. 8(c), and that:

> Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required. . . .

FED. R. CIV. P. 12(b).

Relevant to resolving the arguments raised in Section II is the Full Faith and Credit Act, which provides:

> [The] Acts, records and judicial proceedings or copies thereof [of any State, Territory, or Possession of the United States], so authenticated, shall

> have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

28 U.S.C. § 1738.

STATEMENT OF THE CASE

1. Introduction

This case raises two important questions of federal civil procedure on which the circuits are divided. The first is whether a court of appeals may itself, sua sponte, raise an *expressly waived* defense of res judicata and order the dismissal of a case without ever giving the plaintiff an opportunity to respond to that defense. The second is whether a federal court in New York should give claim-preclusive effect to a foreign state court's dismissal based on that state's statute of limitations, where it is clear that the foreign state follows the traditional rule of treating its statute of limitations as a purely procedural limit on the remedy available in that state, and not as a limit on the substantive right at issue.

While this Court has addressed both questions in *dicta* in two recent decisions, those decisions have not resolved the conflicts among the lower courts. The decision below plainly contradicts the reasoning in this Court's earlier opinions, and plainly violates basic notions of due process. This Court's review, therefore, is warranted.

The procedural context in which these two issues have arisen is remarkable. The Second Circuit affirmed the district court's dismissal of Petitioner AmBase's multi-million dollar lawsuit against Respondents solely on the

ground that its claim was barred, as res judicata, by an earlier Delaware Chancery Court decision dismissing the claim under Delaware's three-year statute of limitations. That result, although plainly wrong (see below), would in and of itself be unremarkable, were it not for the fact that res judicata is an affirmative defense which is waived if not timely raised before the trial court. Here, Respondents not only failed to raise the defense, but expressly *disclaimed* it, twice insisting in its trial court briefs that it "has never raised res judicata, or claim preclusion, as a basis for dismissal of this case." Consistent with this, Respondents never once mentioned the defense, either in their appellate briefs or at argument. Nor did the panel below ever raise the question of whether res judicata applied prior to its ruling on the issue in its opinion. Unsurprisingly, then, AmBase saw no reason to explain in the courts below why the defense of res judicata, had it been raised, was inapplicable to its case.

Instead, AmBase devoted its efforts on appeal to showing why the trial court erred in dismissing AmBase's complaint under New York's six-year statute of limitations. AmBase thus had no opportunity to alert the panel to *Arizona v. California*, 530 U.S. 392 (2000), which makes clear that an appellate court cannot "ordinarily" raise, sua sponte, the defense of res judicata once it has been waived. Emphasizing that the sua sponte application of an otherwise waived res judicata defense "erod[es] the principle of party presentation so basic to our system of adjudication," 530 U.S. at 413, the Court noted that it is appropriate for a court to do so only when it is "'on notice that *it* has previously decided the issued presented,'" *id.* at 412 (quoting *United States v. Sioux Nation*, 448 U.S. 371, 432 (1980)) (emphasis added). Here, the Second Circuit was relying upon AmBase's dismissal by a Delaware court for

failure to satisfy Delaware's three-year limitations period, an issue that was not relevant to AmBase's New York claim. The Second Circuit's sua sponte application of res judicata thereby deepened a circuit conflict on the proper respect to be accorded the waiver rule set forth in FED. R. CIV. P. 8(c), and led the panel into its second error.

Specifically, the panel overlooked this Court's recent observation that "the traditional rule is that expiration of the applicable statute of limitations merely bars the remedy and does not extinguish the substantive right, so that dismissal on that ground does not have claim-preclusive effect in other jurisdictions with longer, unexpired limitation periods." *Semtek Int'l, Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 504 (2001). Under this traditional rule, AmBase's dismissal by a Delaware court for failure to satisfy its *three*-year statute of limitations would clearly not have preclusive effect on AmBase's New York claim, which is subject to a *six*-year statute of limitations. Both New York and Delaware plainly apply this traditional rule. The Second Circuit, however, improperly cited to *federal* case law instead of applying *Delaware* law, as mandated by numerous decisions of this Court. It therefore misapplied the Full Faith and Credit Act by according "greater preclusive effect to a state-court judgment than the state court itself would do." *Johnson v. De Grandy*, 512 U.S. 997, 1005 (1994) (citation omitted).

For the reasons set forth below, we respectfully submit that this Court's review is warranted to resolve the confusion of authority on both questions presented.

2. Factual And Procedural Background

Petitioner AmBase, a Delaware Corporation, was formed in 1975 as a wholly owned subsidiary of City

Investing Company ("City"). In the early 1980s, to manage its self-liquidation, City formed Respondent City Investing Company Liquiding Trust ("Trust"). In 1985, City distributed various assets to its shareholders, including shares in both Petitioner AmBase and Respondent Trust. Although Petitioner AmBase was a separate entity from both City and the Trust, AmBase's officers and directors included several trustees and beneficiaries of Respondent Trust.

At the same time in 1985, Petitioner AmBase and Respondent Trust entered an Assignment Agreement, whereby AmBase accepted responsibility for the consolidated income taxes of the City consolidated group. In 1986, the IRS alleged that a foreign subsidiary of City was liable for outstanding withholding taxes. Although the allegedly deficient withholding tax was not a component of the City group's consolidated income tax, Petitioner AmBase's officers and directors, who were beneficiaries of Respondent Trust, directed AmBase to litigate the tax claim as its own. That litigation was at long last resolved when, in May 2001, the Tax Court ruled that in fact neither Respondent Trust nor Petitioner AmBase was liable for the deficiency. *AmBase Corp. v. Commissioner, IRS*, No. 11816-95, 2001 Tax Ct. Memo LEXIS 150 (May 23, 2001). While that case was pending before the Tax Court, in August 2000, Petitioner AmBase brought suit against both the Trust and several of its former officers and directors (collectively "Respondents"), in the Delaware Chancery Court. AmBase contended that Respondents, and not AmBase, remained responsible for any withholding tax liability, and for the $3.2 million expended by AmBase to defend against it. Concluding that AmBase's claim had accrued no later than December of 1996, the Chancellor found the action procedurally time-barred by Delaware's three-year statute of limitations and laches. After first ruling orally, the Chancellor's order expressly noted that

this was not a "rul[ing] on the merits of the underlying substantive claims." App. at 56a. On AmBase's motion for reconsideration, the Chancellor reiterated his decision in a written opinion. *AmBase Corp. v. City Investing Co.*, No. 18207, 2001 Del. Ch. LEXIS 16 (Feb. 7, 2001).

AmBase promptly filed this action against the same defendants in the United States District Court for the Southern District of New York. Respondents again moved to dismiss the action, this time based on New York's six-year statute of limitations. Although Respondents argued that AmBase was collaterally estopped from contesting certain facts found by the Delaware Chancellor, they never argued that the entire action was res judicata. To the contrary, they specifically disclaimed reliance on res judicata, emphasizing that they "ha[ve] never argued that res judicata bars AmBase from bringing a claim in New York because that claim was previously dismissed in Delaware on statute of limitations grounds," and also that "[t]he Trust has never raised *res judicata*, or claim preclusion, as a basis for dismissal of this case." App. at 63a, 61a. Res judicata is, of course, an affirmative defense that must be affirmatively pleaded under Federal Rule of Civil Procedure 8(c). Accordingly, given Respondents' failure, indeed refusal, to plead it, the District Court neither relied upon, nor even mentioned, the affirmative defense. Rather, the District Court dismissed AmBase's claims as time-barred under New York's six-year statute of limitations. *AmBase Corp. v. City Investing Co. Liquidating Trust*, No. 01-Civ-0771, 2002 U.S. Dist. LEXIS 482 (S.D.N.Y. Jan. 11, 2002).

AmBase appealed to the Second Circuit, where it challenged the District Court's conclusions regarding the New York statute of limitations. Respondents defended the District Court's statute of limitations ruling on its own

merits. No party raised, briefed, or in any other way argued res judicata, nor did the panel raise or allude to res judicata at oral argument. Nevertheless, on April 3, 2003, the Second Circuit issued an opinion in which it concluded that AmBase's entire cause of action was barred by operation of the Delaware Chancery decision. *AmBase Corp. v. City Investing Co. Liquidating Trust*, 326 F.3d 63 (2d Cir. 2003). The panel did so without ever informing either party that it was considering res judicata, inviting briefing, or in any other way affording the parties an opportunity to address the question. App. at 1a-24a.

AmBase immediately filed a petition for rehearing and suggestion of rehearing *en banc*. Eight days later, the Second Circuit issued an "Errata," modifying the panel's opinion by adding a single citation to a Delaware decision applying Delaware's law of res judicata. *Compare* App. at 19a, *with* App. at 68a-69a. AmBase's rehearing petition was then denied without comment. App. at 51a.

REASONS FOR GRANTING THE WRIT

I. THE COURTS OF APPEALS ARE DIVIDED ON WHETHER THEY HAVE PLENARY DISCRETION TO APPLY SUA SPONTE A DEFENSE OF RES JUDICATA WHICH THE DEFENDANT HAS WAIVED.

A. The Second Circuit Erred In Sua Sponte Applying The Waived Defense Of Res Judicata.

Rule 8(c) of the Federal Rules provides that res judicata is an affirmative defense that must be asserted in an appropriate responsive pleading in the trial court, or else it is forfeited. In this case, Respondents not only failed to raise, but expressly disclaimed the defense of res

judicata before the District Court, and they never asserted that defense in the appellate court proceedings. Thus, the question presented is whether the Court of Appeals erred in raising and applying that affirmative defense sua sponte. The Courts of Appeals are clearly divided on this question: the Second, Fifth, Sixth, Eighth, and Ninth Circuits have held that courts are free to act sua sponte to apply the affirmative defense of res judicata even when that defense was not raised, and was thus waived, by the defendant; by contrast, the First, Third, Fourth, Seventh, Tenth, and District of Columbia Circuits have not departed from the traditional rule under which appellate courts will not raise res judicata for the first time sua sponte on appeal. While this Court's decision in *Arizona v. California*, 530 U.S. 392, 412 (2000), indicates that courts are ordinarily not free to act sua sponte to apply res judicata after it has been waived, the decision did not resolve the forgoing circuit split. Review should therefore be granted in this case to ensure a uniform practice among the circuits as to the circumstances under which a court may itself raise res judicata notwithstanding that it has been waived by the defendant.

1. The Federal Rules are clear as to the effect of a failure to timely plead any affirmative defense, including res judicata. Rule 8(c) requires a defendant to set forth any affirmative defense it has to the complaint.[1] Rule

[1] These include accord and satisfaction, arbitration and award, assumption of risk, contributory negligence, discharge in bankruptcy, duress, estoppel, failure of consideration, fraud, illegality, injury by fellow servant, laches, license, payment, release, res judicata, statute of frauds, statute of limitations, waiver, "and any other matter constituting an avoidance or affirmative defense." FED. R. CIV. P. 8(c).

12(b), in turn, requires a party to raise "every defense, in law or fact, to a claim for relief in any pleading . . . in the responsive pleading thereto." FED. R. CIV. P. 12(b). It is well settled that, in the ordinary operation of these two rules, an affirmative defense is waived if not timely raised. *See Arizona*, 530 U.S. at 410; *Taylor v. United States*, 485 U.S. 992, 992 (1988) (White, J., dissenting from denial of certiorari).

"The purpose of such pleading is to give the opposing party notice of the plea of estoppel and a chance to argue, if he can, why the imposition of an estoppel would be inappropriate." *Blonder-Tongue Labs., Inc. v. University of Illinois Found.*, 402 U.S. 313, 350 (1971). The rule promotes both efficiency and fundamental fairness by creating an incentive for defendants to come forward quickly with dispositive defenses, rather than sitting on their rights and potentially "gaming" the system. *See, e.g., Harris v. Secretary, U.S. Dep't of Veteran Affairs*, 126 F.3d 339, 341, 343-45 (D.C. Cir. 1997) (noting that ignoring Rule 8(c) would allow defendants to "omit affirmative defenses in pleadings strategically," thus denying plaintiffs a fair chance to conduct discovery and develop legal strategies on notice of the potential procedural bar).

2. The Second Circuit's decision to revive, sua sponte, an expressly disclaimed res judicata defense is consistent with that court's prior jurisprudence, and with four other circuits that have held that courts have the power to revive waived defenses. While it had not previously addressed whether an appellate court may do so, the Second Circuit has previously endorsed the practice by district courts:

> [W]e have previously upheld a district court's dismissal of a case on collateral estoppel grounds even where collateral estoppel was not raised as an affirmative defense in the answer, but was

> raised by the district court sua sponte, without permitting the party against which it was asserted an opportunity to argue the issue.

Curry v. City of Syracuse, 316 F.3d 324, 331 (2d Cir. 2003) (citing *Doe v. Pfrommer*, 148 F.3d 73, 80 (2d Cir. 1998)).

In addition to the Second Circuit, several courts of appeals have discarded the traditional understanding of Rule 8(c). The Fifth and Eighth Circuits will sua sponte raise a waived preclusion defense for the first time on appeal whenever necessary to affirm the district court. *See Russell v. SunAmerica Sec., Inc.*, 962 F.2d 1169, 1172 (5th Cir. 1992); *American Furniture Co. v. International Accommodations Supply*, 721 F.2d 478, 482 (5th Cir. 1981) ("[W]here all of the relevant facts are contained in the record before us and all are uncontroverted, we may not ignore their legal effect, nor may we decline to consider the application of controlling rules of law to the dispositive facts, simply because neither party has seen fit to invite our attention to the issue by technically correct and exact pleadings. We do so sua sponte.") (citing *W.E. Hedger Transp. Corp. v. Ira S. Bushey & Sons, Inc.*, 186 F.2d 236 (2d Cir. 1951); *Wilson v. United States*, 166 F.2d 527 (8th Cir. 1948)); *Bechtold v. City of Rosemount*, 104 F.3d 1062, 1068 (8th Cir. 1997) ("Where the District Court can be affirmed on different grounds, even though not raised, this court may exercise its discretion to do so.") (citing *Zirinsky v. Sheehan*, 413 F.2d 481, 484 n.5 (8th Cir. 1969)); *accord Robertson v. Interstate Sec. Co.*, 435 F.2d 784, 787 n.4 (8th Cir. 1971).

The Ninth Circuit has a long-standing practice of sua sponte considering waived affirmative defenses so long as it "gives the parties an opportunity to be heard on that issue." *See Jones v. Vasquez*, No. 99-16049, 2000 U.S. App. LEXIS 18673, at *1-2 (9th Cir. July 27, 2000) (unpublished

op.); *accord Hawkins v. Risley*, 984 F.2d 321, 324 (9th Cir. 1993) ("'It is consistent with these principles to permit a court which has been appraised by [a party] of an earlier decision . . . to examine the res judicata effect of that prior judgment sua sponte.'") (quoting *McClain v. Apodaca*, 793 F.2d 1031, 1032-33 (9th Cir. 1986)) (alteration in original); *Nevada Employees Ass'n v. Keating*, 903 F.2d 1223, 1225-26 (9th Cir. 1990) (reversing sua sponte invocation of res judicata where it was done without affording parties opportunity to submit post-trial briefs on the issue).

In *Hutcherson v. Lauderdale County*, 326 F.3d 747, 757 (6th Cir. 2003), the Sixth Circuit, noting *Arizona*, sua sponte gave preclusive effect to a state court judgment for the first time on appeal. The plaintiff had filed parallel state and federal court litigation; however, as the state judgment had not become final until after defendants had moved for judgment on the pleadings in federal court, and as defendants had put plaintiffs on notice as to the possibility of a res judicata defense by pleading duplicative litigation, the Court found "special circumstances" justifying departing from the usual Rule 8(c) bar. *Id.* In endorsing this broader departure from the Federal Rules, these courts point to a number of interests, including "the finality of decisions, conserv[ing] judicial resources, and protect[ing] litigants from multiple lawsuits." *Hutcherson*, 326 F.3d at 757 (quotations omitted); *accord Bechtold*, 104 F.3d at 1068.

3. By contrast, the First, Third, Fourth, Seventh, Tenth, and District of Columbia Circuits have not departed from the traditional rule disapproving of appellate courts applying an unasserted res judicata defense for the first time on appeal. *See infra* note 3. This conflict among the circuits is manifested in the case law, but the case law,

we submit, does not and cannot capture the depth or extent of the conflicting decisions. This is because a court of appeals will rarely (if ever) gratuitously mention in its opinion that it has refrained from considering an apparently meritorious affirmative defense that it has noticed but that was not raised at trial or on appeal. Therefore, circuit court decisions sua sponte applying an unasserted affirmative defense necessarily conflict with innumerable instances in which a court of appeals has refrained from resurrecting and considering even an apparently meritorious but unasserted defense, and (naturally) did not state in its opinion that it was refraining from doing so.

In any event, the circuit split has been expressly recognized. In a case in which neither party appears to have raised the question of whether the waived defense of res judicata might apply, the Seventh Circuit held as follows:

> There is a split of authority whether [the defense of res judicata] may be raised by the court sua sponte or whether failure to preserve it on appeal precludes its applicability. The better rule seems to be that res judicata must be properly preserved on appeal.

Savings & Profit Sharing Fund of Sears Employees v. Gago, 717 F.2d 1038, 1039 n.3 (7th Cir. 1983).[2] Likewise,

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[2] Based on its decision in *Savings & Profit*, the position of the Seventh Circuit on this controversy would appear to be well-established. *See also Crowder v. Lash*, 687 F.2d 996, 1007-08 (7th Cir. 1982) ("Defendants, however, did not properly raise their res judicata defense in the lower court. As an affirmative defense under FED. R. CIV. P. 8(c), res judicata must be properly raised or it is waived."). However, in a recent unpublished opinion, relying on *Arizona*, the Seventh Circuit stated otherwise. "[A]lthough [the plaintiff] is right that ordinarily we will not consider an unpreserved

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one other opinion has recognized that "[t]he circuits are split on the question whether an appellate court may, for the first time, raise the issue [of claim preclusion] sua sponte." *Nixon v. United States*, 978 F.2d 1269, 1297 (D.C. Cir. 1992) (Henderson, J. concurring) (citing cases); *see also* 18 CHARLES ALAN WRIGHT, ET AL., FEDERAL PRACTICE & PROCEDURE (JURISDICTION) § 4405, at 33-35 & nn.4&7 (1998) ("[M]any cases reaffirm the basic rule that both claim preclusion and issue preclusion are affirmative defenses that must be pleaded, and that are waived if omitted. . . . It follows from this general rule that preclusion cannot be raised for the first time on appeal." Nevertheless, "a few have raised the question of preclusion on their own motion, and it has even been raised by appellate courts for the first time on appeal.").

Beyond the split over whether a court of appeals may, without any instigation or briefing from the parties, raise and apply a waived defense of res judicata, the Second Circuit's decision also highlights the division of authority over whether a court of appeals may properly deviate from the strictures of Rule 8(c) even *if* a party asks it to do so. Allowing a party to resurrect its waived defense, of course, is not as radical a departure from normal practice as having the court do so sua sponte, without allowing any briefing or argument on the issue. Nevertheless, a majority of circuits

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ground for affirming, such as res judicata, we do have discretion to consider the argument – for example where the proper resolution is beyond doubt. Indeed we may consider the question solely of our own initiative, if it is plain from the complaint and other papers on file that res judicata renders the case frivolous." *Walker v. Page*, No. 00-3990, 2003 U.S. App. LEXIS 4412, at *10-11 (7th Cir. Mar. 11, 2003) (unpublished op.) (internal citations omitted).

have expressly rejected the argument that Rule 8(c) can be abrogated upon the defendant's request.[3]

4. In *Arizona v. California*, 530 U.S. 392, 412 (2000), this Court briefly discussed, in *dicta*, the appropriateness of a court raising a waived res judicata argument sua sponte. In doing so, it did not address the disagreement among the circuits outlined above, nor did it seek to resolve that disagreement. Instead, it simply refused to apply claim preclusion where the parties seeking to invoke it had failed to raise it earlier in the litigation, recognizing that the principles of preclusion, including Rule 8(c), "rank res judicata an affirmative defense ordinarily lost if not timely raised." *Id.* at 410. Having dispatched of the waived argument in this fashion, the Court went on to reject the suggestion that it could raise the preclusion argument sua

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[3] *See Badway v. United States*, 367 F.2d 22, 25 (1st Cir. 1966) ("Even if these [res judicata and statute of limitations] defenses had merit the defendant is not entitled to the benefit of either of them now. Under Rule 8(c) [they] must be set forth affirmatively in the pleadings."); *Kane v. Heckler*, 776 F.2d 1130, 1131-32 (3d Cir. 1985) ("Res judicata is an affirmative defense, and such a defense may not be presented on appeal if not pleaded in the district court.") (internal citations omitted); *Dellums v. Powell*, 566 F.2d 167, 178 n.13 (D.C. Cir. 1977); *Crowe v. Cherokee Wonderland, Inc.*, 379 F.2d 51, 54 (4th Cir. 1967) ("the defense of res judicata, not having been raised affirmatively below, has been waived" and cannot be raised for the first time on appeal); *Schramm v. Oakes*, 352 F.2d 143, 150 (10th Cir. 1965) ("The defenses of res judicata and collateral estoppel are affirmative defenses, must be raised as such on the trial level and cannot be raised for the first time upon appeal."); *accord Stearn v. Department of the Navy*, 280 F.3d 1376, 1380 (Fed. Cir. 2002) (limiting district court's ability to sua sponte revive waived affirmative defense); *Esslinger v. Davis*, 44 F.3d 1515, 1524 (11th Cir. 1995) (same, noting that in all non-habeas cases, "we would not hesitate to condemn as a gross abuse of discretion, if not clear error, the trial court's sua sponte interposition of an affirmative defense that the defendant did not plead").

sponte. *Id.* at 395. In *dicta*, it suggested that "[j]udicial initiative of this sort might be appropriate in special circumstances," but then identified only one such "special circumstance," which relates solely to the ability of a trial court to control and husband its own resources by refusing to permit relitigation of claims that were previously adjudicated by that very court:

> [I]f a court is on notice that it has previously decided the issue presented, the court may dismiss the action sua sponte, even though the defense has not been raised. This result is fully consistent with the policies underlying res judicata: it is not based solely on the defendant's interest in avoiding the burdens of twice defending a suit, but is also based on the avoidance of unnecessary judicial waste.

Id. at 412 (quoting *United States v. Sioux Nation*, 448 U.S. 371 (1980) (Rehnquist, J., dissenting) (citations omitted)). In *Arizona* itself, the preclusion argument was based upon prior decisions of this Court sitting in original jurisdiction over the longstanding water rights dispute at issue there; nevertheless, the Court refused to apply res judicata once it had been waived because "this Court plainly has not 'previously decided the *issue* presented.'" *Id.* It also noted that even under the special circumstances alluded to in the forgoing passage, a court's authority to act sua sponte remains limited by the strictures of due process. "Where no judicial resources have been spent on the resolution of a question, trial courts must be cautious about raising a preclusion bar sua sponte, thereby eroding the principle of party presentation so basic to our system of adjudication." *Id.* at 412-13.

5. This Court's *dicta* in *Arizona* did not purport to resolve, and did not in fact resolve the split among the circuits on when if ever it is appropriate for a court of appeals to sua

sponte raise and apply the waived defense of res judicata. For example, the Second Circuit's decision to apply res judicata sua sponte in this case obviously cannot be justified by the "special circumstances" outlined in *Arizona*. Neither the Second Circuit nor the Southern District of New York was "on notice that *it* [had] previously decided the issue presented." *Arizona*, 530 U.S. at 412 (quotation and citation omitted) (emphasis added); *cf. Stearn v. Department of the Navy*, 280 F.3d 1376, 1380 (Fed. Cir. 2002) (concluding that in light of *Arizona*, where the legal issue raised in the subsequent action was not present in the purportedly preclusive action, "special circumstances" for waiving Rule 8(c) are not present). To the contrary, the Second Circuit's decision gave preclusive effect to a foreign state court judgment, which had dismissed AmBase's suit on an issue (Delaware's three-year statute of limitations) that was itself irrelevant to AmBase's New York lawsuit. Ignoring Respondents' own explicit rejection of the affirmative defense, the Second Circuit made no effort to identify a single "special circumstance" justifying departure from the usual waiver rule, nor did it cite this Court's opinion in *Arizona*. It did not mention Rule 8(c), nor did it even acknowledge that it was acting sua sponte. It simply applied the waived defense, without even providing AmBase with notice of the issue, let alone an opportunity to address it prior to the court's rendering its decision. App. at 1a-24a.

6. This Court should review the Second Circuit's opinion in this case to resolve this conflict in the circuits, and to rule that federal appellate courts do not have the power to revive the waived defense of res judicata absent the narrow and identified special circumstances referenced in *Arizona*. This issue arises in innumerable contexts throughout the federal system, and the absence of a uniform rule has lead to and will continue to yield conflicting

results that will encourage forum shopping. Moreover, if the Second Circuit's decision is allowed to stand, then the Rule 8(c) waiver will be eviscerated: any party that has waived its defense will nonetheless argue that the circuit court should revive the defense "sua sponte." Finally, as the Second Circuit's decision here demonstrates (*see infra*, Section III), by raising and resolving an unasserted affirmative defense sua sponte, an appellate court abandons the principle of "party presentation," the bedrock to our judicial system, *Arizona*, 530 U.S. at 413, and in so doing unnecessarily risks uninformed and erroneous decisionmaking.

B. The Second Circuit Violated AmBase's Due Process Rights By Failing To Give AmBase Notice And Opportunity To Respond To The Waived Defense Of Res Judicata.

As this Court has repeatedly and consistently held, "there can be no doubt that at a minimum [due process] require[s] that deprivation of life, liberty or property by adjudication be preceded by notice and opportunity for hearing appropriate to the nature of the case." *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 313 (1950). Both the Fifth and Fourteenth Amendments guarantee the right to be heard, "at a meaningful time and in a meaningful manner." *Armstrong v. Manzo*, 380 U.S. 545, 552 (1965).

In line with these bedrock principles, the constitutional right to a hearing must limit the ability of an appellate court to rule against an appellant based upon a defense that was waived in the District Court, never briefed on appeal, and never mentioned by the appellee or the court during oral argument. To be sure, the Due

Process Clause may not be implicated simply because an appellate court rules sua sponte against a litigant on a ground that was not briefed and that did not come up at argument. But this case is far more egregious than that: under the Federal Rules and this Court's precedents, Respondents not only had failed to affirmatively plead the affirmative defense of res judicata, it affirmatively renounced the defense. The traditional application of Rule 8(c) denies plaintiff an affirmative defense even when it is merely forfeited by non-pleading; here it was affirmatively waived. *See United States v. Olano*, 507 U.S. 725, 733 (1993) ("Whereas forfeiture is the failure to make the timely assertion of a right, waiver is the 'intentional relinquishment or abandonment of a known right.'") (quoting *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938)).

AmBase therefore had every right to expect the Second Circuit to apply the normal waiver rule. The law must "give[] people confidence about the legal consequences of their actions," and courts, no more than legislatures, should not lightly "sweep away settled expectations suddenly and without individualized consideration." *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265-67 (1994). *See also Harris*, 126 F.3d at 343-45 (detailing prejudice to defendants by failure to enforce notice requirement of Rule 8(c)). At a minimum, AmBase had a right to expect to be given an opportunity to address the issue if the Court decided to raise it sua sponte.[4] The Second Circuit nullified

[4] Nearly every other court to touch upon the issue has at the very least required notice and an opportunity to be heard. *See, e.g., Dempsey v. Sears Roebuck & Co.*, No. 91-2167, 1992 U.S. App. LEXIS 20672, at *5 (1st Cir. June 5, 1992) ("Any potential surprise from a sua sponte dismissal due to an unanticipated defense can be avoided by first

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these reasonable expectations through a judicial broadside: ruling against AmBase on an issue that was expressly waived by the defendant in the trial court and never mentioned on appeal, without ever giving AmBase an opportunity to explain why that defense had no merit in any event.[5]

This Court recognized in *Arizona* that dismissing sua sponte an action on a theory that was not raised by the defendant not only violates Rule 8(c), it runs contrary to the basic procedural norms of our system. "Where no judicial resources have been spent on the resolution of a question, trial courts must be cautious about raising a preclusion bar sua sponte, thereby eroding the principle of party presentation so basic to our system of adjudication." 530 U.S. at 412-13. This is particularly so at the appellate level, where a litigant's only real recourse is appeal to this Court's discretionary jurisdiction.

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allowing the defendant to be served and given an opportunity to brief the issue or otherwise complete the record."); *Russell*, 962 F.2d at 1172 (allowing affirmative defense to be raised on appeal, but requesting supplemental briefing on the defense); *Stonelight Tile, Inc. v. Bay Area Air Quality Mgmt. Dist.*, Nos. 99-16381 & 99-17037, 2001 U.S. App. LEXIS 920 (9th Cir. Jan. 18, 2001) (reversing district court for sua sponte dismissal on statute of limitations without first giving the parties an opportunity to brief and address the issue).

[5] To be sure, AmBase was able to raise this point in its petition for rehearing. But surely appellate courts cannot invoke and apply waived defenses in resolving cases and require the losing party to come back to the court on petition for rehearing, with a heavy presumption against it, to plead against those grounds. The appellate courts simply cannot devote the same resources to petitions for rehearing as they must to appeals in the first instance, and it would be fundamentally unfair to allow those primary decisions to be made on bases never addressed by the parties.

This Court recognized the very same difficulty in *Burns v. United States*, 501 U.S. 129 (1991), where it was invited to interpret Federal Rule of Criminal Procedure 32. There, the trial court had, without notice, departed upwards from the parties' agreed-upon sentencing recommendation. "In this case, were we to read Rule 32 to dispense with notice, we would then have to confront the serious question whether notice in this setting is mandated by the Due Process Clause." *Id.* at 138 (citing *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988) (the Court will construe statutes so as to avoid raising serious constitutional questions)).[6]

In short, dismissing a case at the appellate level on an issue affirmatively waived in the trial court and never addressed by the parties cannot be squared with the Fifth Amendment's minimum requirement of notice and opportunity to be heard. This Court's review is warranted to establish this vital principle.[7]

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[6] Similarly analogous is *Societe Internationale Pour Participations Industrielles et Commerciales, S.A. v. Rogers*, 357 U.S. 197, 209-10 (1958), wherein the Court recognized that it would violate the due process clause to dismiss a cause of action for failure to comply with a court order, where the means of complying lie beyond the party's control.

[7] This Court's review by writ of certiorari in addition to being appropriate to resolve circuit splits, is also permissible where the court of appeals has "so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's supervisory power." SUP. CT. R. 10(a). By ruling sua sponte, without inviting either briefing or argument on an issue that Respondents had in fact expressly disavowed, the Second Circuit departed wholesale from the ordinarily adversarial process, and in doing so trenched upon AmBase's reasonable expectations to a modicum of procedural due process. Resort

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II. THE SECOND CIRCUIT'S RES JUDICATA ANALYSIS MISAPPLIED THE FULL FAITH AND CREDIT ACT.

Just two years ago, this Court unanimously held that "the traditional rule is that expiration of the applicable statute of limitations merely bars the remedy and does not extinguish the substantive right, so that dismissal on that ground does not have claim-preclusive effect in other jurisdictions with longer, unexpired limitation periods." *Semtek Int'l, Inc. v. Lockheed Martin Corp.*, 531 U.S. 497, 504 (2001). Delaware clearly follows this traditional rule.[8] While purporting to follow Delaware law, however, the Second Circuit flatly contradicted this traditional rule. It did so not by misinterpreting Delaware law, per se, but by failing to recognize that federal law, in the form of the Full Faith and Credit Act ("FFCA"), 28 U.S.C. § 1738, required it to undertake a specific inquiry which it failed to make: instead of merely asking whether a statute of limitations dismissal is thought to be "on the merits" (which was the inquiry undertaken in the decisions which *Semtek* overruled), the Second Circuit should have inquired into whether Delaware's statute of limitations is merely a "procedural" limit on the remedy available in that state, or is instead a "substantive" qualification of the right itself.

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to this Court's supervisory authority is particularly appropriate as to the due process issue, because in this instance even developing a disagreement among the circuits is unlikely: because the due process violation occurs only in the circuit's own sua sponte ruling, only rarely if ever would the circuit panel even address the issue.

[8] *See generally Tiffany v. O'Toole Realty Co.*, 153 A.2d 195, 199-200 (Del. Super. Ct. 1959); *Equity Corp. v. Groves*, 53 A.2d 505 (Del. Ct. 1947); *Cappello v. Patrician Towers, Inc.*, No. 102, 1981 Del. LEXIS 272, at *2-3 (Del. Jan. 14, 1981).

The FFCA requires "a federal court [to] give a ... state-court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered." *Migra v. Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75, 81 (1984). By the same token, the FFCA prevents "a federal court [from] accord[ing] greater preclusive effect to a state court judgment than the state courts themselves would give to it." *Marrese v. American Acad. of Orthopaedic Surgeons*, 470 U.S. 373, 387 (1985) (Burger, C.J., concurring) (*citing Migra*).[9] Of course, state courts will not often, if ever, have cause to address whether a dismissal in one of their *own* courts for failure to satisfy their *own* statute of limitations precludes the plaintiff from bringing a similar action in the courts of *another* state, in which a longer statute of limitations will apply. For this reason, when federal courts have sought to apply a state's res judicata law to determine the preclusive effect of that state's judgment, they have resorted to one of two distinct inquires: Some courts, like the Second Circuit in this case, have undertaken a rather superficial inquiry into whether that state considers

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[9] As this Court has made clear, "[t]he preclusive effect of a state court judgment in a subsequent federal lawsuit generally is determined by the full faith and credit statute . . . ." *Marrese v. American Acad. of Orthopaedic Surgeons*, 470 U.S. 373, 380 (1985). Accordingly, it is well-established that this Court has ultimate authority to correct any federal court's erroneous decision to dismiss a case as barred by the res judicata effect of a prior state court dismissal. *See generally id.* (reversing Seventh Circuit's decision that earlier state court dismissal barred federal antitrust claim); *Migra v. Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75 (1984) (vacating Sixth Circuit decision holding that employee's federal claim was barred by prior state court dismissal).

a statute of limitations dismissal to be "on the merits."[10] While that inquiry might have sufficed under what this Court described as "the original connotation of an 'on the merits' adjudication," *Semtek*, 531 U.S. at 501, it cannot suffice as a proper inquiry under the FFCA today, because, as this Court held in *Semtek*, "it is no longer true that a judgment 'on the merits' is necessarily a judgment entitled to claim-preclusive effect." *Id.* at 503. Other courts, by contrast, have undertaken a deeper inquiry into whether the statute of limitations of the state in which judgment was entered was intended to be a substantive limit on the cause of action that was alleged, or was instead intended to be merely a procedural limit on the remedies available for violation of that right in that state.[11]

The correctness of this latter inquiry is confirmed by this Court's jurisprudence: traditionally, states "did not regard statutes of limitations as substantive provisions, akin to the rules governing the validity and effect of contracts, but rather as procedural restrictions fashioned by each jurisdiction for its own courts." *Sun Oil Co. v.*

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[10] *See, e.g., EFCO Corp. v. U.W. Marx, Inc.*, 124 F.3d 394 (2d Cir. 1997); *Austin v. Super Valu Stores*, 31 F.3d 615 (8th Cir. 1994); *see also Marinkovic v. Casey, Gerry, Casey, Westbrook, Reed*, No. 96-56657, 1998 U.S. App. LEXIS 2043 (9th Cir. Feb. 10, 1998).

[11] *See generally Reinke v. Boden*, 45 F.3d 166 (7th Cir. 1995); *Rose v. Town of Harwich*, 778 F.2d 77 (1st Cir. 1985); 18 MOORE'S FEDERAL PRACTICE § 131.30[g] (2003) ("If the statute is considered substantive under state law (and is said to extinguish the right), then a prior judgment on the statute must be given claim-preclusive effect in a subsequent action in federal court, but if the state classifies the statute as procedural (and therefore only affects the remedy), then the federal court must follow the state's preclusion law and deny the state court judgment preclusive effect."); *see also id.* at nn.100-02 (citing cases undertaking inquiry into whether statute of limitations was substantive or procedural).

Wortman, 486 U.S. 717, 725 (1988). Under this traditional view, "the bar of the statute does not extinguish the underlying right but merely causes the remedy to be withheld." *Id.* As this Court stated in *Semtek*, this "traditional rule" means "that dismissal on [statute of limitations] ground[s] does not have claim-preclusive effect in other jurisdictions with longer, unexpired limitation periods." *Semtek*, 531 U.S. at 504.

In light of this traditional rule, we submit that the better view among the divided circuits[12] is that a federal court can conclude that a state court's statute of limitations dismissal is res judicata only by first concluding that the limitation rule in question is *not* a purely procedural limit on the remedy available in that state, but is instead intended to be a constraint on the substantive right in question.[13] For example, in *Reinke v. Boden*, 45 F.3d 166 (7th Cir. 1995), the Seventh Circuit addressed whether a Minnesota court's dismissal of a complaint as time-barred precluded a subsequent diversity case in Illinois federal

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[12] *Compare supra* n.10 with n.11.

[13] This conclusion must be reached as a matter of federal law, because a failure to inquire into whether the state's limitations period is substantive or procedural necessarily risks committing one of two fatal errors in applying the FFCA: (1) if the statute of limitations is a procedural limit on the remedy available in that state's jurisdiction, then a decision by the federal court giving the earlier dismissal res judicata effect would "accord greater preclusive effect to [the] state court judgment than the state courts themselves would give to it," *Marrese*, 470 U.S. at 387; (2) by contrast, in the comparatively rare case where the statute of limitations is a limit on the substantive right at issue, then a decision by the federal court not to dismiss on res judicata grounds would fail to "give [the] state court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered." *Migra*, 465 U.S. at 81.

court. To resolve "the difficult question of the correct characterization of the Minnesota judgment," it first recognized that "[s]tatutes of limitations have traditionally been characterized as falling into one of two categories": those which are "an integral part of the cause of action; when the statute of limitations runs, the cause of action is extinguished," and "[t]he second and more common type of statute of limitations [which] does not extinguish the cause of action upon the running of the limitations period; only the possibility of obtaining a remedy in the forum is gone." *Id.* at 169. In language strikingly similar to this Court's statement in *Semtek*, the Seventh Circuit explained that res judicata does not attach to dismissals based upon violations of this latter, "more common" type of limitations rule:

> [U]nder this traditional approach, a dismissal under this form of statute of limitations does not bar a subsequent suit in another jurisdiction. It simply means that the cause of action cannot be heard in the jurisdiction of dismissal because that jurisdiction considers suits of that vintage to be stale. That judgment establishes only that the suit is time-barred in the state of rendition; it says nothing about a suit in the second jurisdiction.

Id.

Thus, before looking into the nature of the Minnesota statute of limitations at issue in *Reinke*, the Seventh Circuit set forth the basic proposition that there is a fundamental distinction between "traditional" and "substantive" limitation rules in resolving "the command of

§ 1738." *Id.* Other circuit court decisions,[14] as well as decisions of state courts of last resort[15] likewise recognize that in resolving the preclusive effect of a prior state court dismissal on statute of limitations grounds, "the crucial question is whether the rendering state considers the particular statute of limitations to be substantive or procedural." 18 MOORE'S FEDERAL PRACTICE § 131.30[g].

The Second Circuit decision in this case failed to ask this "crucial question," and thereby violated the FFCA because it gave the Delaware court's dismissal "greater preclusive effect" than would the Delaware courts. *See Marrese*, 470 U.S. at 387. It is well established "that Delaware statutes of limitations are generally regarded as procedural." *Tiffany v. O'Toole Realty Co.*, 153 A.2d 195, 199-200 (Del. Super. Ct. 1959); *see also Cheswold Volunteer Fire Co. v. Lambertson Constr. Co.*, 489 A.2d 413, 421 (Del. 1984). For that reason, in Delaware it likewise is "well established that a judgment based on the forum's statute of limitations is not a ruling on the merits and is not, therefore, entitled to res judicata effect in a later action in another jurisdiction." *Cappello v. Patrician Towers, Inc.*, No. 102, 1981 Del. LEXIS 272, at *2-3 (Del. Jan. 14, 1981); *see also Equity Corp. v. Groves*, 53 A.2d 505 (Del. Ch. 1947).

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[14] *See generally Rose v. Town of Harwich*, 778 F.2d 77, 80 (1985) (distinguishing cases that "rest upon the traditional distinction between 'right' and 'remedy' and the traditional assertion that a 'procedural' statute of limitations extinguishes only the 'remedy' not the 'right' "); *Clenson v. Columbus Bank & Trust*, 651 F.2d 320, 324 (5th Cir. 1981) (statute of limitations dismissal "signifie[d] only that [the state's] courts may not be used to litigate an otherwise actionable . . . claim").

[15] *Brand v. Brand*, 116 Ky. 785 (1903); *Weinburg v. Johns-Manville Sales Corp.*, 473 A.2d 22 (Md. 1984); RESTATEMENT OF JUDGMENTS § 49, cmt. a (1942).

The Second Circuit's fundamental error is further demonstrated by the case law on which it relied in concluding that "[t]he dismissal of the Delaware Action was adverse to AmBase and was a dismissal on the merits." App. at 19a. Quite apart from the fact that the Chancellor himself recognized that his dismissal of AmBase for failure to satisfy the statute of limitations was *not* "on the merits," App. at 55a-56a, all three of the cases cited by the panel addressed the preclusive effect of a prior dismissal by a court *in the same jurisdiction* as that in which the pending action was brought. App. at 19a, 68a-69a (citing *Loving v. Pirelli Cable Corp.*, 11 F. Supp. 2d 480 (D. Del. 1998) (prior dismissal by same District Court was preclusive), *aff'd without op.*, 178 F.3d 1279 (3d Cir. 1999); *Williamson v. Columbia Gas & Elec. Corp.*, 91 F. Supp. 874 (D. Del.) (same), *aff'd*, 186 F.2d 464 (3d Cir. 1950); *Townsend v. Chasanov*, No. 129, 1995 Del. LEXIS 367 (Del. Oct. 11, 1995) (prior dismissal by Delaware Justice of the Peace Court was preclusive on subsequent case brought in Delaware Superior Court)).[16] These cases do not address the question of whether Delaware's statute of limitations is considered to be merely a procedural limit on remedies in Delaware, or is instead intended to be a substantive limit on Delaware causes of action, and they therefore cannot be relevant to the question the FFCA required the Second Circuit to answer. And two of the three decisions were *federal* cases applying solely the *federal* law of res judicata. *See Loving*, 11 F. Supp. 2d 480 (D. Del. 1998);

[16] The Second Circuit by an Errata to its original opinion, added its citation to the Delaware case only after AmBase filed its petition for rehearing.

Williamson, 91 F. Supp. 874 (D. Del. 1950).[17] Since these federal cases have nothing at all to do with Delaware's law of res judicata, the Second Circuit's reliance upon them contradicted prior decisions of this Court,[18] as well as the plain dictates of the FFCA. Worse still, the Second Circuit relied upon *Loving* even though this Court's decision in *Semtek* essentially overturned it: contrary to the analysis set forth in *Loving*, this Court held in *Semtek* that Rule 41(b) does not control the inquiry of whether a decision is "on the merits" for purposes of applying res judicata.[19]

In sum, the panel's decision, like the case law that has now been overturned by *Semtek*, failed to undertake the

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[17] Both cases involved federal courts adjudicating federal questions, in which they considered the res judicata effect of prior federal courts adjudicating federal questions; in such a context, it is well established that solely federal law principles of res judicata are applicable. *See generally Stoll v. Gottlieb*, 305 U.S. 165, 171-72 (1938); *Gunter v. Atlantic Coast Line R.R. Co.*, 200 U.S. 273 (1906); 18 CHARLES ALAN WRIGHT, ET AL., FEDERAL PRACTICE & PROCEDURE (JURISDICTION) § 4466 ("federal courts must establish their own rules to prescribe the res judicata effects of their own federal question judgments in later litigation that again presents a federal question to a federal court").

[18] *See, e.g.*, *Allen v. McCurry*, 449 U.S. 90 (1980); *Migra*, 465 U.S. at 81; *Marrese*, 470 U.S. at 380.

[19] In relying on doubtful federal caselaw applying federal preclusion law, the Second Circuit has created a situation whereby a litigant in AmBase's shoes in the future will obtain different treatment in New York state court than in New York federal court. In New York state court, "[a] dismissal on statute of limitations grounds by another state would not, by itself, bar the bringing of an action in [that court] on res judicata grounds." *See SafeCard Servs., Inc. v. American Express Travel Related Servs. Co.*, 203 A.D.2d 65, 66 (N.Y. App. Div. 1994). This is no longer true in the New York federal courts. By creating such an opportunity for forum shopping, the Second Circuit has also blatantly contravened *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938), and its progeny.

essential inquiry into whether Delaware considers its statute of limitations to be procedural or substantive. While we acknowledge that the Second Circuit's plain error on this issue might not, in and of itself, warrant this Court's review, it serves to underscore the potential consequence of appellate abrogation of the waiver rules of Rule 8(c) through sua sponte decision-making. And because the Second Circuit's error was committed in conjunction with its erroneous decision to sua sponte raise and apply the expressly disclaimed defense of res judicata, we respectfully submit that this question likewise warrants this Court's review.

CONCLUSION

For the forgoing reasons, petitioners respectfully request that the petition for a writ of certiorari be granted.

September 10, 2003

Respectfully submitted,

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AMBASE CORPORATION, A Delaware Corporation, Plaintiff-Appellant, -v.- CITY INVESTING COMPANY LIQUIDATING TRUST, as successor to City Investing Company, a dissolved Delaware Corporation, JOHN J. QUIRK, Trustee of City Investing Company Liquidating Trust, and MARION SCHARFFENBERGER, Executrix of the Estate of George T. Scharffenberger, EBEN W. PYNE, Individually and as Trustee of the City Investing Company Liquidating Trust, LESTER J. MANTELL, Individually and as Trustee of the City Investing Company Liquidating Trust, Defendants-Appellees.
Docket No. 02-7230

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

326 F.3d 63; 2003 U.S. App. LEXIS 6366

November 7, 2002, Argued
April 3, 2003, Decided

As Amended April 24, 2003

COUNSEL: MARK R. KRAVITZ, Wiggin & Dana LLP, New Haven, CT (Victor A. Bolden, Wiggin & Dana, LLP, New Haven, CT, Philip Halpern, Collier, Halpern, Newberg, Nolletti & Bock, LLP, White Plains, NY, on the briefs), for Plaintiff-Appellant.

PAUL M. DODYK, Cravath, Swaine & Moore, New York, NY, for Defendants-Appellees.

JUDGES: Before: WALKER, Chief Judge, and OAKES and MINER, Circuit Judges.

OPINION BY: MINER MINER

OPINION:

MINER, Circuit Judge:

This is an appeal from a final judgment entered in the United States District Court for the Southern District of New York (Stanton, J.), dismissing on the pleadings a diversity action brought by plaintiff-appellant AmBase Corporation ("AmBase") against defendants-appellees for indemnification of legal expenses incurred in a tax dispute with the Internal Revenue Service ("IRS"). This dispute concerned certain tax liabilities that allegedly were assumed by the predecessor corporation of defendant-appellee City Investing Company Liquidating Trust (the "Trust"). The District Court dismissed the complaint upon a finding that the express contractual indemnification claim pleaded therein failed to state a claim upon which relief could be granted and that the restitution, unjust enrichment, implied contract, and breach of fiduciary duty claims were time barred by New York's statute of limitations. The District Court further denied AmBase leave to amend its complaint because the breach of contract and breach of third-party beneficiary contract claims AmBase sought to add in its amended complaint were also time barred.

This is AmBase's second bite at the litigation apple, its first bite having been taken in an action filed in the Delaware Chancery Court, *see AmBase Corp. v. City Inv. Co. Liquidating Trust,* CA No. 18207-NC (Del. Ch.) ("Delaware Action"), which was dismissed as time barred by Delaware's shorter statute of limitations. For the reasons that follow, we conclude that AmBase's claims are barred as a matter of law by the doctrine of res judicata. Accordingly, we affirm the judgment of the District Court without reaching the merits of whether AmBase's various claims either fail to state a claim upon which relief can be granted or are time barred.

BACKGROUND

I. The Parties

City Investing Company ("City") was a publicly-held Delaware holding company that was dissolved and liquidated in 1985. Before its dissolution and liquidation, City was the holding company for a multinational conglomerate with subsidiaries in the manufacturing, housing, and insurance industries. *AmBase Corp. v. Comm'r,* 2001 Tax Ct. Memo LEXIS 150, 81 T.C.M. (CCH) 1657, 1657, 2001 T.C. Memo 122 (2001). One of City's wholly-owned subsidiaries was the Home Group, Inc., which changed its name to AmBase in 1989.[1] AmBase owned several operating subsidiaries, including the Home Insurance Company, and in the mid 1980s held assets in excess of $5 billion. *AmBase,* 81 T.C.M. (CCH) at 1658.

In 1985, as part of its dissolution and liquidation, City consummated a transaction pursuant to which it distributed out its assets and liabilities. The relevant detail of this transaction was that City distributed the outstanding shares of AmBase to City's common stockholders. At the same time, the Trust was formed to, "among other things, assume all of the claims, liabilities, and obligations" of City that were "not otherwise provided for." The Trust was initially funded with assets having an aggregate estimated value of approximately $200 million. City's shareholders were the beneficiaries of the Trust and received ownership units in it. Between 1985 and 1990, the Trust distributed over $280 million in cash and assets to the former stockholders of City.

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[1] For the sake of simplicity, we refer to this entity as "AmBase."

Certain directors and officers of City ("Trustee Defendants") occupied certain fiduciary positions with both AmBase and the Trust. Defendant-appellee George Scharffenberger[2] was a Trustee of the Trust since its creation and served as Chairman of the Board of Directors of AmBase from prior to 1985 until January 1993, and as AmBase's Chief Executive Officer from March 1990 until May 1991. Defendant-appellee Eben Pyne has been a Trustee of the Trust since its creation and was a member of the AmBase Board from prior to 1985 until January 1993. And defendant-appellee Lester Mantell has served as a Trustee of the Trust since its creation, had been a senior City officer before the AmBase spin-off, and served in several officer positions (including Treasurer and Chief Financial Officer) at AmBase from prior to 1985 until December 1996. While at AmBase, Mantell (a tax attorney) had significant responsibility for AmBase's tax matters.

II. The Assignment of Certain Liabilities From City to AmBase

Pursuant to an August 1985 Assignment Agreement, AmBase assumed certain liabilities of City in consideration for City's payment of $178,767,000 and the unwinding of certain debits and credits relating to intercorporate transactions. Among those liabilities were City's obligations for federal income taxes as the common parent of

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[2] Scharffenberger died after the notice of appeal in this case was filed. By Order dated May 13, 2002, this Court substituted John J. Quirk as a Trustee and Marion Scharffenberger, executrix of the Estate of George Sharffenberger, as defendants.

City's corporate affiliates. In addition, AmBase assumed certain other liabilities and obligations of City, provided that AmBase would be only secondarily liable for the payment of those liabilities.

Shortly after the Assignment Agreement was executed, City and the Trustees entered into a Trust Agreement. AmBase was not a party to the Trust Agreement. Among other things, the Trust Agreement provided that the Trustees were to "assume all the claims, liabilities, and obligations (including unascertained or contingent liabilities in expenses) of [City]" listed on Schedule I of the Trust Agreement. Schedule I listed among the liabilities assumed "any cost, expense or liability associated with any claim asserted against City with respect to any act or omission attributable to its operations or affairs which has not been discharged in full or adequately provided for." In addition, Schedule I included, as a liability of the Trust, the costs and liabilities incurred in the defense of any litigation arising after September 25, 1985, in which City Investing was a defendant. Tax liabilities were not expressly mentioned in Schedule I.

III. Tax Dispute

During the latter half of the 1970s, City sought access to the Eurobond market to obtain long-term financing at a fixed rate of interest and to reduce the amount of indebtedness it had borrowed from its American bankers under a revolving credit agreement. *AmBase,* 81 T.C.M. (CCH) at 1658. At this time, "the practice in the Eurobond market was for issuers of securities to provide indemnification for

withholding taxes to foreign investors." *Id.*[3] Without such indemnification, "foreign investors would not have purchased Eurobond obligations . . . because the imposition of withholding taxes would decrease their [rate of] return on the Eurobond obligations." *Id.*

During this time, American companies looking to raise money in the Eurobond market often formed a wholly-owned subsidiary in the Netherlands Antilles, which would issue debt securities in the Eurobond market that were guaranteed by the American parent corporation. *Id.* The Netherlands Antilles subsidiary would then lend the Eurobond offering proceeds to the U.S. parent or one its affiliates. *Id.* In certain circumstances, the American parent company's payment of interest on its indebtedness to the Netherlands Antilles subsidiary would be exempt from American withholding taxes "by reason of the application of the U.S.-Netherlands Income Tax Convention, as extended by protocol to the Netherlands Antilles." *Id.*

In 1974, City formed a wholly-owned subsidiary in the Netherlands Antilles. In 1977 and 1979, City raised $30 million and $50 million, respectively, from the Eurobond market through its Netherlands Antilles subsidiary. *Id.* at 1659. "The payment of principal and interest on these

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[3] Sections 871(a)(1) and 881(a)(1) of the Internal Revenue Code (the "Code") "generally impose a tax of 30 percent on amounts received as interest from sources within the United States by nonresident alien individuals and foreign corporations." *AmBase,* 81 T.C.M. (CCH) at 1661. "Payers of such interest are generally required under sections 1441 and 1442 [of the Code] to deduct and withhold therefrom an amount equal to the tax imposed by sections 871 and 881 [of the Code], and in the event that they fail do so so they are liable for those withholding taxes under section 1461 [of the Code]." *Id.*

notes was unconditionally guaranteed by City." *Id.* Furthermore, the notes provided that the issuer would indemnify the holders with respect to any American withholding taxes that might be imposed. *Id.* City's Netherlands Antilles subsidiary immediately lent the proceeds from the Eurobond offering to City. *Id.* In May 1984, the 1977 notes were repaid in full. *Id.* at 1661. In September 1985, City liquidated and dissolved its Netherlands Antilles subsidiary, and the remaining debt on the 1979 notes was "upstreamed" to City. *Id.*

In or about March 1986, the IRS issued a Revenue Agent's Report to City contending that City had failed properly to withhold taxes during tax years 1979 and 1980 for the interest payments it made to the foreign holders of the Eurobonds. The IRS claimed that this subsidiary did not meet the requirements for exemption from United States withholding taxes.[4] The IRS later extended that claim to the period covering tax years 1981 through 1985. The amount of the withholding at issue was almost $21 million. As of March 1986, the accrued interest on that sum was about $10 million.

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[4] In 1984, Congress prospectively "repealed the 30-percent withholding tax imposed by Sections 871 and 881 [of the Code] with respect to certain interest paid on portfolio debt, referred to as 'portfolio interest'." *AmBase,* 81 T.C.M. (CCH) at 1661. For preexisting obligations, such as those of City, "special transitional relief [was provided] from withholding taxes applicable to interest payments" for corporations that "met requirements based on the 'principles' of certain previously revoked [IRS] revenue rulings. . . . " *Id.* Essentially, the IRS alleged that City had not met the requirements for transitional relief that would have exempted it from the obligation to pay withholding taxes.

In 1986, AmBase did not pay the taxes alleged to have been owed.[5] Moreover, AmBase did not demand that the Trust pay the taxes allegedly owing, nor did it demand that the Trust assume the defense against the IRS. On or about May 11, 1995, the IRS issued a Notice of Deficiency to AmBase, claiming entitlement to the funds that it alleged should have been withheld.

On or about June 29, 1995, AmBase filed a petition with the United States Tax Court on behalf of City contesting the alleged tax liability. By 1995, the accrued interest on the withholding obligation of $21 million had risen to $61 million for a total liability of over $80 million. AmBase did not seek to bring the Trust into the case or to sue the Trust. A little over three-and-a-half years then passed, during which time AmBase did not claim that the Trust was primarily responsible for the withholding taxes.

IV. Delaware Action

On August 14, 2000, AmBase filed a two-count complaint against the Trust and the Trustee Defendants for declaratory and injunctive relief in the Delaware Chancery Court, contending that the potential withholding tax obligation that it had been apprised of fourteen years earlier was not its primary responsibility under the Assignment Agreement. AmBase sought a preliminary injunction preventing the Trust from making distributions

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[5] If it had done so, the running of further interest would have been cut off, and if it ultimately proved that the taxes were not owed, AmBase would have received interest to compensate it for the loss of the time value of its money. *See* Rev. Proc. 84-58, 1984-2 C.B. 501; *see also* I.R.S. Announcement 86-108, 1986-45 I.R.B. 20.

that would endanger the Trust's ability to pay the withholding tax liability, which had by then grown to $141 million.[6] AmBase also sought the recovery of $3.2 million in legal expenses and related costs that it had allegedly incurred in connection with the IRS dispute and the Tax Court litigation. In particular, AmBase alleged that, when the IRS dispute arose during the 1980s, the Trustee Defendants apparently taking the position that AmBase was primarily responsible for the alleged withholding obligation, caused AmBase to effectively assume the costs and expenses of defending against the alleged withholding obligation without obtaining independent professional advice or guidance concerning whether the alleged withholding obligation was the primary obligation of Ambase, or the Trust, as successor to [City]. Competent and independent professional advisors likely would have informed management that the alleged withholding obligation was an obligation for which the Trust [was] primarily liable.

Count I of the complaint in the Delaware Action sought an order "declaring that the Trust, as successor to [City], is primarily liable for any alleged withholding obligation that is the subject of the [Tax Court litigation]" and alleged that such liability was based on "the Trust Agreement and the Assignment Agreement." In Count II, captioned "Restitution and Implied Contract," AmBase alleged that the Trust had been "unjustly enriched" by AmBase's expenditure of the $3.2 million in legal expenses

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[6] Eight months before the Delaware Action was commenced, the Trust reported having assets with an aggregate value of approximately $73 million, slightly more than half of the potential withholding tax liability.

associated with the Tax Court litigation and that "equity imposed an obligation on the Trust to repay [these] costs and expenses incurred on [the Trust's] behalf by AmBase," which was "entitled to restitution from the Trust" for these expenditures. In September 2000, the Trust and the Trustees moved to dismiss the Delaware Action on the grounds that the causes of action alleged were time barred by the Delaware statute of limitations and that the complaint failed to state claims upon which relief could be granted.

In a December 14, 2000 ruling from the bench (which was later memorialized in an unpublished order dated February 3, 2001), the Delaware Chancery Court dismissed the Delaware Action with prejudice "solely on the ground that it [was] barred by the statute of limitations and the doctrine of laches." In ruling from the bench, the Chancery Court began its analysis by describing the claims alleged by AmBase as essentially saying: "This primary liability was never contractually shifted from [City] to AmBase. It never was there in the first place. We shouldn't be dealing with this. It is not within the scope of the agency that we took on." Turning to the question of the timeliness of the Delaware Action, the Chancery Court stated:

> Giving AmBase all of its due, the claim began to run at least as early as the notice of deficiency, because if you don't act on the notice of deficiency by challenging it, it is going to be reduced to a judgment. All along this has been a sum certain, and interest has been running.

The Chancery Court then turned to AmBase's allegations that Delaware's three-year statute of limitations should have been equitably tolled because the Trustee

Defendants' presence on AmBase's Board of Directors created a conflict of interest that prevented the Board from acting sooner. The court began its analysis with the facts pleaded in the complaint that there were no Trustees remaining on AmBase's Board by the end of 1995 and that, by the end of 1996, Trustee Mantell stopped serving as an officer of AmBase. Therefore, by the end of 1996, "this cloud that supposedly kept this corporate entity from discovering a claim that was based on a contract that was out there in the open" had been lifted.

The Chancery Court issued an unpublished written decision dated February 7, 2001, in which it denied AmBase's motion for reargument and sought to expound further on its ruling from the bench. After recapping the facts of the case, the court characterized its prior discussion of when AmBase's claims accrued as follows:

> In sum, AmBase's claims that the Trust [was] primarily responsible for the potential withholding tax liability, that it should be required to set aside assets sufficient to satisfy that liability, and that it and not AmBase should bear the cost of contesting the liability were surely ripe as of 1995, if not in 1986. These claims could also have been explicitly framed as breaches of the Trust's obligations under the Assignment Agreement; they are in fact pled implicitly as such now.

(footnotes omitted).

The court then turned to its earlier treatment of AmBase's equitable tolling argument (i.e., that the Trustee Defendants "fraudulently concealed the basis for AmBase's claims or that the claims were inherently undiscoverable before all of [the Trustee Defendants had] departed [from] AmBase"). The court noted "how thin" it had found AmBase's

equitable tolling argument to be based on the facts that (1) a majority of AmBase's Board had always been comprised of directors who were not affiliated with the Trust and who were aware of the Trustee Defendants' affiliations with the Trust; and (2) the facts necessary to learn of AmBase's potential liability for the withholding taxes were contained in the Assignment Agreement and the Code, neither of which was "concealed." Even though the court had found AmBase's equitable tolling argument to be "weak," it noted that, "in the end" it had not based its dismissal on a "holding that the statute of limitations began to run *before* the last of the Trustee Defendants had left AmBase," i.e., in 1986 or 1995. (emphasis added). Instead, the court held that the equitable tolling argument lacked merit, assuming for the purposes of that holding that AmBase's claims accrued as late as December 1996.

V. District Court Proceedings and Resolution of the Tax Dispute

In January 2001 (after the Delaware Chancery Court had dismissed the Delaware Action but while AmBase's motion for reargument of that decision was pending), AmBase commenced the action giving rise to this appeal by filing a six-count complaint in the District Court against the Trust and the Trustee Defendants. The factual allegations in this complaint closely mirrored those in the complaint filed in the Delaware Action. For example, in Count I of the complaint, AmBase once again sought a declaration that the Trust rather than AmBase was primarily liable for the payment of the disputed withholding taxes and accrued interest, alleging that the liabilities AmBase assumed in the Assignment Agreement did not include the obligation to pay the withholding taxes, which

accordingly fell among the other liabilities of City that were assumed by the Trust. AmBase also again sought a declaration that it was entitled to reimbursement from the Trust of the $3.2 million in legal expenses that AmBase had incurred in the Tax Court litigation. In addition to this declaratory relief, AmBase once again sought injunctive relief preventing the Trustees from winding up the Trust's affairs or disbursing any Trust assets to the beneficiaries of the Trust. And, in Count II of the complaint, AmBase once again alleged causes of action sounding in restitution, unjust enrichment, and implied contract, seeking the return of the $3.2 million in legal expenses that AmBase had incurred in the Tax Court litigation.

AmBase also alleged two additional causes of action that are relevant to this appeal.[7] In Count III of the complaint, AmBase alleged that the Trustee Defendants breached the fiduciary duties that they owed to AmBase as a result of the conflicts of interest created by their dual service as Trustees of the Trust and officers and directors of AmBase. In particular, AmBase alleged that the Trustee Defendants breached their fiduciary duties to AmBase by: (i) "improperly attempting to impose upon AmBase a purported withholding tax obligation that was and remained the lawful obligation of the Trust"; (ii) "failing or refusing to obtain independent and competent advice concerning the subject of whether the alleged withholding obligation was properly the responsibility of the Trust";

[7] AmBase has not pursued on appeal the District Court's dismissal of its remaining claims for fraudulent conveyance and professional negligence/malpractice that were alleged, respectively, in Counts V and VI of the complaint.

(iii) "causing AmBase to incur substantial expenses, including attorneys' fees, in attempting to eliminate or minimize the potential exposure relating to the alleged withholding obligation"; (iv) "failing to properly inform new management of AmBase that the withholding tax obligation was one that [was] properly borne, if at all, by the Trust"; and (v) "causing the Trust to distribute hundreds of millions of dollars to [City's] former stockholders [i.e., the beneficiaries of the Trust] when they knew or, in the absence of gross negligence should have known, that the Trust was primarily liable for the alleged withholding[ ] obligations."

In addition to its breach of fiduciary duty claim, AmBase also pleaded a cause of action sounding in indemnification in Count IV of the complaint. In particular, AmBase alleged, pursuant to the Assignment Agreement or the Trust Agreement, that it was entitled to contractual indemnification from the Trust for the legal expenses it incurred in the Tax Court litigation.

In February 2001, the Defendants moved, pursuant to Fed. R. Civ. P. 12(b)(6), to dismiss AmBase's complaint on the ground that, inter alia, the causes of action pleaded therein were barred by New York's six-year statute of limitations. The gravamen of the Defendants' motion was that AmBase's claims accrued in 1986 – the date when the IRS issued its Revenue Agent's Report – and that the Delaware Chancery Court's decision in the Delaware Action collaterally estopped AmBase from claiming otherwise. Thus, the Defendants argued, AmBase's claims were time barred some time in 1992. Alternatively, the Defendants argued that, if AmBase's claims accrued as late as December 1996 (when the last of the Trustee Defendants departed from AmBase), under New York's "discovery

rule,"[8] AmBase had only two additional years from 1996 in which to file suit, so its claims were time barred after 1998.

While the District Court action was pending, on May 23, 2001, the Tax Court resolved the dispute between AmBase and the IRS in favor of AmBase, holding that neither City nor AmBase was liable for the withholding taxes on the interest payments made to the foreign bond holders. *See AmBase,* 81 T.C.M. (CCH) at 1670. The IRS did not appeal. Consequently, because the Tax Court held in favor of AmBase and there was no longer any liability for the withholding taxes, AmBase's only remaining claim before the District Court was for the $3.2 million in legal expenses, which it alleged that the Trust should pay.

Following its victory in the Tax Court, AmBase sought leave in October 2001 to amend its complaint to include two additional causes of action – one for breach of contract and one for breach of a contract to which AmBase was a third-party beneficiary. In the breach of contract claim, AmBase alleged that the Trust breached the Assignment Agreement by: (i) "designating AmBase as [City's] agent for purposes of the [tax dispute with the IRS] and refusing

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[8] New York's discovery rule provides, in relevant part, that:

> Where the time within which an action must be commenced is computed from the time when facts were discovered or from the time when facts could with reasonable diligence have been discovered, or from either of such times, the action must be commenced within two years after such actual or imputed discovery or within the period otherwise provided, computed from the time the cause of action accrued, whichever is longer.

N.Y. C.P.L.R. 203(g) (McKinney 2002).

to acknowledge the primary liability therefor"; (ii) "transferring the [tax dispute with the IRS] to AmBase"; and (iii) "failing to be primarily liable for the payment, discharge and performance of the obligations associated with the [tax dispute with the IRS] and the costs and expenses of the [Tax Court litigation] and otherwise failing to live up to the terms and conditions of the Assignment Agreement." In the third-party beneficiary claim, AmBase alleged that it was an intended third-party beneficiary of the Trust Agreement between City and the Trust and that the Trust breached the Trust Agreement by failing to "compensate AmBase for its costs, expenses, and legal fees associated with [the Tax Court litigation]." The District Court decided to defer consideration of AmBase's request for leave to amend its complaint until after it had addressed the Defendants' motion to dismiss the original complaint.

In an unpublished opinion and order dated January 11, 2002, the District Court granted the Defendants' motion to dismiss. As an initial matter, the District Court rejected the Defendants' collateral estoppel argument, finding that the Delaware Chancery Court had not specified that AmBase's claims accrued in 1986. According to the District Court, all that was needed to support the Chancery Court's decision that those claims were time barred under the Delaware three-year statute of limitations was that the claims accrued no later than August 14, 1997, i.e., three years before the commencement of the Delaware Action. In particular, the District Court reasoned that no finding had been made by the Chancery Court other than that "the claims were barred because they accrued at some earlier time and nothing supported a tolling of the [Delaware] statute of limitations beyond 1996, which was over three years before AmBase" commenced the

Delaware Action. The District Court then dismissed as a matter of law the restitution, unjust enrichment, implied contract, and breach of fiduciary duty claims as being time barred. The District Court agreed with the Defendants' argument that these claims accrued either in 1986 (in which case they were time barred six years later in 1992) or in 1996 (in which case they were time barred two years later in 1998). The District Court next dismissed AmBase's contractual indemnity claim for failing to state a claim upon which relief could be granted. In reaching this conclusion, the District Court interpreted the Assignment Agreement as not providing for indemnification as a matter of law.

Six days later, the District Court entered final judgment dismissing all of AmBase's claims. On January 25, 2002, AmBase moved, pursuant to Fed. R. Civ. P. 59(e) and 60(b), to alter or amend the judgment and again requested leave to amend its complaint to include the breach of contract and third-party beneficiary contract claims referenced above. The District Court denied AmBase's motion by a memorandum endorsement dated February 14, 2002, stating that the proposed amendments to AmBase's complaint would be "futile because they would do nothing to alter the date of accrual under the six year statute of limitations . . . which applies equally to actions upon an express or an implied contractual obligation or liability." This timely appeal followed.

DISCUSSION

I. Standard of Review

A complaint should not be dismissed pursuant to Fed. R. Civ. P. 12(b)(6) for failure to state a claim upon which

relief can be granted " 'unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.' " *Cooper v. Parsky,* 140 F.3d 433, 440 (2d Cir. 1998) (quoting *Conley v. Gibson,* 355 U.S. 41, 45-46, 2 L. Ed. 2d 80, 78 S. Ct. 99 (1957)). A court's task "in ruling on a Rule 12(b)(6) motion 'is merely to assess the legal feasibility of the complaint, not to assay the weight of the evidence which might be offered in support thereof.' " *Cooper,* 140 F.3d at 440 (quoting *Ryder Energy Distribution Corp. v. Merrill Lynch Commodities Inc.,* 748 F.2d 774, 779 (2d Cir. 1984)). Furthermore, a court must "accept as true all factual allegations in the complaint." *Cooper,* 140 F.3d at 440. Finally, "we are entitled to affirm ... on any ground for which there is support in the record, even if not adopted" by the District Court. *Adirondack Transit Lines, Inc. v. United Transp. Union, Local 1582,* 305 F.3d 82, 88 (2d Cir. 2002). In particular, we can affirm the dismissal of a complaint for failure to state a claim based on the affirmative defense of res judicata if "all relevant facts are shown by the court's own records," of which we can take judicial notice. *Day v. Moscow,* 955 F.2d 807, 811 (2d Cir. 1992).

II. Res Judicata

Where there is a final state court judgment, a federal court looks to that state's rules of res judicata to determine the preclusive effect of that judgment. *Town of Deerfield, N.Y. v. FCC,* 992 F.2d 420, 429 (2d Cir. 1993) (citing 28 U.S.C. § 1738). Thus, to determine the preclusive effect of the judgment in the Delaware Action, we must look to the Delaware courts' rules of res judicata. In Delaware, a claim is barred by res judicata if: (1) the court that adjudicated the prior action had jurisdiction to do so; (2) the

parties to the subsequent action are the same as (or privies to those in) the prior action; (3) the causes of action in both cases are the same or the subsequent action arises from the same transaction that formed the basis of the prior action; (4) the merits in the prior action were decided adversely to the contentions of the plaintiff; and (5) the prior action was final. *Maldonado v. Flynn,* 417 A.2d 378, 381 (Del. Ch. 1980). Here, four of these five elements need not detain us long. The Chancery Court plainly had subject matter and personal jurisdiction to adjudicate the Delaware Action. The parties to the Delaware Action were the same as the parties to the case at bar. The dismissal of the Delaware Action was adverse to AmBase and was a dismissal on the merits. *See Loving v. Pirelli Cable Corp.,* 11 F. Supp. 2d 480, 491-92 (D. Del. 1998) (dismissal of action by a Delaware court as time barred by the Delaware statute of limitations is a dismissal on the merits for res judicata purposes), *aff'd mem.,* 178 F.3d 1279 (3d Cir. 1999); *Williamson v. Columbia Gas & Elec. Corp.,* 91 F. Supp. 874, 880 (D. Del.) (same), *aff'd,* 186 F.2d 464 (3d Cir. 1950); *Townsend v. Chasanov*, No. 129, 1995, 1995 Del. LEXIS 367 (Oct. 11, 1995) (same).". Finally, the judgment dismissing AmBase's claims in the Delaware Action was final.[9]

The only element to which we must devote further attention concerns whether the causes of action were the same in both cases or whether the instant action arises

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[9] Although on March 8, 2001, AmBase appealed the Chancery Court's decision to the Delaware Supreme Court, AmBase voluntarily dismissed its appeal two weeks later, *see AmBase Corp. v. City Inv. Co. Liquidating Trust,* No. 106,2001 (Del.) (Docket Entry Nos. 4-6).

from the same transaction that formed the basis of the Delaware Action. This "transactional view" of claim preclusion was succinctly explained by the Delaware Chancery Court in *Maldonado*:

> In earlier times the doctrine of res judicata could be invoked only to bar the relitigation of the same cause of action already litigated and determined. . . . The modern transactional view of the doctrine of res judicata, however, does not require that the claim subsequently asserted be based on [the] same cause of action to be barred, but permits the doctrine to be invoked to bar litigation between the same parties if the claims in the later litigation arose from the same transaction that formed the basis of the prior adjudication. . . . The determination, therefore, whether the doctrine shall be invoked is now based on the underlying transaction and not on the substantive legal theories or types of relief which are sought. Under the modern rule, ordinarily, a transaction gives rise to only one claim regardless of the number of ways that the claim may be asserted. . . . In deciding whether res judicata will bar [a] suit, [the plaintiff's claims] must therefore be analyzed in the light of the transaction [that] he challenges; and, if [the plaintiff's] complaint [in the previous action] and his complaint [in the subsequent action] assert different substantive theories concerning but one claim arising from but one transaction, the doctrine of res judicata may prohibit a second adjudication.

417 A.2d at 381-82 (citations omitted). Here, "transaction" refers to a "common nucleus of operative facts." *Schnell v. Porta Sys. Corp.*, CA No. 12,948, 1994 Del. Ch. LEXIS 47, at *11 (Apr. 12, 1994) (citing *Maldonado*); *see also Restatement (Second) of Judgments* § 24 cmt. b (1982). In

other words, "if the pleadings framing the issues in the first action would have permitted the raising of the issue sought to be raised in the second action, and if the facts were known, or could have been known to the plaintiff in the second action at the time of the first action," then the claims in the second action are precluded. *Ezzes v. Ackerman,* 43 Del. Ch. 420, 234 A.2d 444, 445-46 (Del. 1967). This rule against claim splitting "is based on the belief that it is fairer to require a plaintiff to present in one action all of his theories of recovery relating to a transaction, and all of the evidence relating to those theories, than to permit him to prosecute overlapping or repetitive actions in different courts or at different times." *Maldonado,* 417 A.2d at 382. Therefore, when "a plaintiff has had a full, free and untrammelled opportunity to present his facts, but has neglected to present some of them or has failed to assert claims [that] should in fairness have been asserted, he will ordinarily be precluded by the doctrine of res judicata from subsequently pressing his omitted claim in a subsequent action." *Id.* (internal quotation marks omitted).

Turning to the causes of action pleaded here, we initially note that the causes of action, facts alleged, and relief sought in Counts I and II of the original complaint (declaratory relief, injunctive relief, restitution, implied contract, and unjust enrichment) are virtually the same as those pleaded in Counts I and II of the complaint in the Delaware Action. These claims are thus precluded.

With respect to the two additional claims pleaded here that were not pleaded in the Delaware Action (breach of fiduciary duty and express contractual indemnification), they too are precluded because, although they are different substantive theories from those pleaded in the Delaware

Action, they concern but one claim arising from but one common nucleus of operative facts. For example, the allegations underlying the breach of fiduciary duty claim essentially state that the Trustee Defendants could not serve as both Trustees of the Trust and officers/directors of AmBase because they suffered from a conflict of interest. This conflict of interest allegation was encompassed in the issue framed in the Delaware Action: whether the Trust or the Trustee Defendants improperly failed to assume City's withholding tax liabilities. In fact, this conflict of interest was litigated and decided by the Delaware Chancery Court when it rejected AmBase's equitable tolling argument on the grounds that (1) the Trustee Defendants comprised a minority of the AmBase Board and therefore were unable to influence the position taken by AmBase with regard to the tax payments and (2) all the relevant information necessary for the disinterested directors (who made up a majority of AmBase's Board) to determine whether AmBase was required to pay the disputed taxes was available to all.

With respect to the contractual indemnification claim, that too arose out of the same common nucleus of facts that gave rise to the claims pleaded in the Delaware Action and also sought reimbursement of the litigation expenses incurred in the Tax Court litigation. Specifically, the complaint in the Delaware Action alleged that "pursuant to the Trust Agreement and the Assignment Agreement, the alleged withholding obligation is the primary responsibility of the Trust." Indeed, the Chancery Court said of the claims pleaded in the Delaware Action that

they "could also have been explicitly framed as breaches of the Trust's obligations under the Assignment Agreement" and were "in fact pled implicitly as such."[10]

Turning to the claims pleaded in AmBase's proposed amended complaint, it cannot be gainsaid that the breach of contract and breach of third-party beneficiary contract claims also arose out of the same common nucleus of facts as the claims alleged in the Delaware Action. Each of these claims could have been brought in the Delaware Action because they sought reimbursement of the Tax Court litigation expenses pursuant to agreements that were relied on in the Delaware Action.

Accordingly, we conclude that the claims brought in the District Court were barred by the doctrine of res judicata either because they were the same claims brought in the Delaware Action or because they arose from the same common nucleus of facts as the claims in the Delaware Action. Because we are affirming on this alternative basis, we decline to reach the question of whether the District Court properly dismissed AmBase's indemnification claim for failing to state a claim upon which relief could be granted and its remaining claims as time barred under New York's statute of limitations.

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[10] On appeal, AmBase characterizes its indemnification claim as both an express indemnification claim and an implied indemnification claim. While we are skeptical about whether the complaint can be read to include an implied indemnification claim, such a claim would, in any event, be precluded for the same reasons that we find the express indemnification claim is precluded: it arises out of the same common nucleus of facts that was the subject of the Delaware Action.

CONCLUSION

For the foregoing reasons, the judgment of the District Court is affirmed.

AmBASE CORPORATION, A Delaware corporation, Plaintiff, v. CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, and GEORGE T. SCHARFFENBERGER, EBEN W. PYNE and LESTER J. MANTELL, Individually and as Trustees of the CITY INVESTING COMPANY LIQUIDATING TRUST, Defendants.

01 Civ. 0771 (LLS)

UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

2002 U.S. Dist. LEXIS 482

January 11, 2002, Decided
January 15, 2002, Filed

COUNSEL: For AMBASE CORPORATION, plaintiff: Philip M. Halpern, Collier, Halpern, Newberg, Nolletti & Bock, L.L.P., White Plains, NY.

JUDGES: LOUIS L. STANTON, U.S.D.J.

OPINION BY: LOUIS L. STANTON

OPINION: Opinion and Order

Defendants move to dismiss the complaint as barred by the statute of limitations. The motion is granted.

Background

Plaintiff AmBase Corporation ("AmBase"), a Delaware corporation with its principal place of business in Connecticut, was formed in 1975 as a wholly owned subsidiary of City Investing Company ("City Investing"). In 1985, in anticipation of the dissolution and liquidation of City Investing, AmBase and City Investing entered an Assignment and

Assumption Agreement ("Assignment Agreement") in which AmBase assumed certain liabilities of City Investing, including an obligation to pay certain income taxes. At about the same time, defendant City Investing Company Liquidating Trust ("the Trust") was formed to assume the liabilities of City Investing "not otherwise provided for." Compl., ¶ 3. Thereafter, City Investing was dissolved and liquidated. Three former AmBase officers and directors, George T. Scharffenberger, Eben W. Pyne, and Lester J. Mantell, have been trustees of the Trust since 1985, although none has been an officer or director of AmBase since Mantell left it in 1996.

In March 1986, as a result of an audit of a City Investing subsidiary, the United States Internal Revenue Service ("IRS") issued a Revenue Agent's Report claiming that AmBase, as agent for City Investing, owed certain amounts which should have been withheld for income tax purposes (the "withholding taxes") in the years 1979 and 1980 from payments made by a subsidiary of City Investing. AmBase began to incur legal expenses and other fees (for which it now seeks compensation from the Trust) in 1986 in an effort to resolve the complexities involved, and to persuade the IRS that City Investing did not owe the withholding taxes.

Over the next few years, the IRS issued other reports in the same connection for the tax years 1981 to 1986.

On May 11, 1995 the IRS filed a Notice of Deficiency, seeking a total of $20.9 million in withholding taxes plus interest from AmBase. On June 29, 1995, AmBase sued in Tax Court, contesting the IRS's claim.

In January 2001 AmBase brought this suit against the Trust seeking a declaration that the Trust rather than

AmBase was primarily liable for the $20.9 million in withholding taxes and $120 million in accrued interest by then sought by the IRS, arguing that the liabilities AmBase assumed in the Assignment Agreement did not include the obligation to pay the withholding taxes, which accordingly fell among the other City Investing liabilities assumed by the Trust. AmBase also sought reimbursement from the Trust of $3.2 million AmBase had spent in legal fees. Finally, AmBase sought compensatory damages against the individual trustees for breach of fiduciary duty and against defendant Lester Mantell (a tax lawyer, former AmBase officer, and present trustee of the Trust) for professional negligence and malpractice, for his alleged concealment and failure to advise AmBase that the liability was the Trust's.

Recently, on May 23, 2001, the Tax Court held in favor of AmBase. *See AmBase Corp. v. Commissioner of Internal Revenue,* T.C. Memo 2001-122, 81 T.C.M. (CCH) 1657, 2001 Tax Ct. Memo LEXIS 150 (United States Tax Court, May 23, 2001). It held that neither City Investing nor AmBase was liable for the withholding taxes. The IRS did not appeal. Because the Tax Court held in favor of AmBase and there is no liability for the withholding taxes, AmBase's only remaining damages are the $3.2 million in legal fees, which it claims the Trust should pay.

The defendants move to dismiss under the New York six-year statute of limitations (except as to the malpractice claim, see page 14 below) and claim collateral estoppel in their favor, based on a December 14, 2000 decision of Chancellor Strine of the Delaware Court of Chancery dismissing a suit, substantially similar to this one, which AmBase filed in 2000 in that court. Chancellor Strine ruled from the bench that AmBase's claims were barred by

the Delaware three-year statute of limitations and laches ("Strine Ruling"). On February 7, 2001, he denied AmBase's motion for reargument ("Reargument Opinion").

In its motion to dismiss the Delaware suit, the defendants argued that AmBase's claims accrued in March 1986, when the IRS first issued the report claiming that AmBase, on behalf of City Investing, owed withholding taxes. Defendants asserted that the last possible accrual date of the plaintiff's claims was December 1996, when Mantell left AmBase, because thereafter AmBase could no longer claim tolling of the statute of limitations while the trustee-defendants were "fraudulently concealing the Trust's liability from AmBase." Compl., ¶ 1. Thus, since the suit was commenced in 2000, it was barred by the Delaware three-year statute. Chancellor Strine agreed and dismissed it.

In this present suit, the defendants again assert that the claims accrued in 1986, rendering them untimely under the six-year New York statute of limitations. They also urge that, even if plaintiff's claims were tolled while Mantell allegedly fraudulently concealed AmBase's rights from AmBase, that tolling ceased when he left in 1996. Defendants argue that under the discovery rule, N.Y. C.P.L.R. 203(g), plaintiff only had two additional years from 1996 in which to sue, and suit was barred after 1998.

AmBase argues that its claims did not accrue until 2000, when it discovered and asserted them, and the Trust rejected its demands. Alternatively, it asserts that its claim for indemnity of its legal fees and costs accrued in 2001, when the Tax Court issued its decision. Finally, AmBase submits that its claims accrued at the earliest in 1995, when the IRS issued its Notice of Deficiency, or in

1996, when Mantell left AmBase, making them timely under the New York six-year limitations period[1].

Discussion

1.

Defendants assert that Chancellor Strine held that AmBase's claims accrued in 1986, which they say is a determination that collaterally estops AmBase from asserting that its claims accrued later.

Chancellor Strine's actual holding was that AmBase's claims were untimely under the Delaware three-year statute of limitations. All that was needed to support that holding was his finding that, whenever the claims accrued, it was more than three years before AmBase sued on August 14, 2000. It was sufficient for Chancellor Strine to state, as he did, that AmBase's claims against the defendants were "surely ripe as of 1995, if not in 1986" (Reargument Opinion, at 9). Chancellor Strine did not fix the exact date when the claims accrued. Rather, he held that the claims were barred because they accrued at some earlier time and nothing supported a tolling of the statute of limitations beyond 1996, which was over three years before AmBase brought suit. In denying AmBase's motion for reargument, Chancellor Strine stated (p. 14-18):

> But, in the end, I did not rest my dismissal decision on a holding that the statute of limitations

[1] Except the malpractice claim, which AmBase does not dispute is time barred by a three-year limitations period.

began to run before the last of the Trustee Defendants had left AmBase.

Instead, I noted the undisputed fact that all of the Trustee defendants had left AmBase's service by December 1996. Thus, any influence the Trustee Defendants had over AmBase was gone as of that point.

. . .

I held that it was clear that AmBase's claims were ripe as of December 1996, that any influence of the Trustee Defendants was gone as of that time, that AmBase possessed all the knowledge it needed to file suit within three years of that time, and that it did not do so.

Since Chancellor Strine's statements about accrual dates for AmBase's claims[2] earlier than 1996 were dicta, relitigation of that question is not precluded. Because New York has a longer statute of limitations for almost all of

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[2] *E.g.:*

I think that kind of suit could have been brought in 1986. . . .

. . .

And I think it is proven that the case could have been brought by the fact that the case now seeks defense costs back to 1986. . . . Giving AmBase all of its due, the claim began to run at least as early as the notice of deficiency, because if you don't act on the notice of deficiency by challenging it, it is going to be reduced to judgment.

(Strine Ruling, at 3-4); "At that time, I reasoned that AmBase could have brought this action against the Trust as early as 1986, when the Revenue Report was issued, and certainly by 1995, when the Notice of Deficiency was issued." (Reargument Opinion, at 8).

AmBase's claims, this court must determine their exact date of accrual.

2.

A. Restitution, Unjust Enrichment and Implied Contract Claims

AmBase alleges that "Since 1986, AmBase has incurred legal expenses and related costs in the amount of approximately $3.2 million in connection with the IRS dispute and the Withholding Tax Litigation," Compl., ¶ 19, and seeks "all of its costs and expenses incurred in defending against the alleged tax obligation and in prosecuting the Withholding Tax Litigation including its reasonable attorneys' fees," *id.*, p. 17, ¶ C. AmBase claims that the defendants were "unjustly enriched as a result of the benefit conferred at AmBase's expenses [sic] by the payment of these legal fees." *Id.*, ¶ 32.

A claim for unjust enrichment "starts to run upon the occurrence of the wrongful act giving rise to a duty of restitution." *Congregation Yetev Lev D'satmar, Inc. v. 26 Adar N.B. Corp,* 192 A.D.2d 501, 596 N.Y.S.2d 435, 437 (A.D. 2nd Dep't 1993) (citation omitted). The "wrongful act" alleged in the complaint occurred when the defendant-Trustees "endeavored to foist such alleged withholding tax liability upon AmBase," Compl., ¶ 17, which was "when the withholding tax dispute with the IRS arose in the mid-1980s." *Id.*, ¶ 15. As Chancellor Strine put it, "as AmBase's claims for reimbursement for its expenses back to 1986 demonstrates, AmBase had a litigable dispute with the Trust over which entity should have to deal with the IRS." Reargument Opinion, at 9. AmBase's complaint alleges that "Since 1986, AmBase has incurred expenses" unjustly

enriching the Trust, which had the primary obligation to pay the expenses.

On the case as a whole, these claims accrued in 1986, when AmBase received the Revenue Agent's Report and began the work, and incurring the costs, of opposing it. The Notice of Deficiency issued in 1995 continued, but did not commence, the process of defense and the incurring of its costs.

AmBase's position, reiterated in all its claims, is that the statute of limitations begins to run when it learned that the Trust, not AmBase, should have paid these costs.

The statute of limitations, however, runs from the time of a breach or injury and "'knowledge of the occurrence of the wrong on the part of the plaintiff is not necessary.'" *Ely-Cruikshank Co. v. Bank of Montreal,* 81 N.Y.2d 399, 599 N.Y.S.2d 501, 503, 615 N.E.2d 985 (Ct. App. 1993) (quoting *Varga v. Credit-Suisse,* 5 A.D.2d 289, 171 N.Y.S.2d 674). No fresh breach or "wrongful act giving rise to a duty of restitution" occurred in 1995, 1996 or 2000.

When, through no fault of its own, a plaintiff lacks knowledge of its claims because the defendant concealed them (as alleged here), the statute of limitations is equitably tolled until "'plaintiff either acquires actual knowledge of the facts that comprise [its] cause of action or should have acquired such knowledge through the exercise of reasonable diligence after being apprised of sufficient facts to put [it] on notice.'" *Glynwill Investments, N.V. v. Prudential Securities, Inc.,* 1995 U.S. Dist. LEXIS 8262, 1995 WL 362500 (S.D.N.Y. June 16, 1995), at *3, quoting *City of Detroit v. Grinnell Corp.,* 495 F.2d 448, 460 (2d Cir. 1974). That tolling does not change the time the claim accrued, but merely excuses a delay in suit until actual or imputed

discovery. At that point, the situation is governed by N.Y. C.P.L.R. § 203(g) which provides:

> where the time within which an action must be commenced is computed from the time when facts were discovered or from the time when facts could with reasonable diligence have been discovered, or from either of such times, the action must be commenced within two years after such actual or imputed discovery or within the period otherwise provided, computed from the time the cause of action accrued, whichever is longer.

In this case, that means within six years from 1986 when the claims accrued, or two years from when they should have been discovered, whichever is longer.

As Chancellor Strine held, any equitable tolling due to the trustee's misrepresentations ended in 1996, when all of the trustees left the service of AmBase (Reargument Opinion, at 14-15):

> Given that the Assignment Agreement was fully available to AmBase, as was the IRS Code, there was no reason why AmBase could not have asserted its claim within three years after Mantell's December 1996 departure. AmBase had full notice of the fact that the Assignment Agreement was the basis for it assuming primary liability for City's withholding tax liability. AmBase thus had the information to decide whether to assert a claim. All its board or management had to do was instruct someone to read the contract and the IRS Code.
>
> . . .
>
> Given all these circumstances, I held that AmBase's argument that the statute of limitations

was equitably tolled beyond December 1996 to be without merit.

Since the unjust enrichment and related claims accrued in 1986, under the six-year statute of limitations, N.Y. C.P.L.R. § 213(2) (McKinney 2000), they are untimely when calculated from their date of accrual. When calculated from their imputed time of discovery in 1996, they are untimely because this present suit was not commenced within the additional two years granted by New York's discovery rule, C.P.L.R. § 203(g), *see Glynwill,* 1995 U.S. Dist. LEXIS 8262, 1995 WL 362500, at *4 ("Because the doctrine of equitable tolling is subsumed within § 203(g), *Riis v. Manufacturers Hanover Trust Co.,* 632 F. Supp. 1098, 1105 n.4 (S.D.N.Y. 1986), applicability of that doctrine cannot extend the limitations period beyond the two years prescribed by the statute."). Under any view, the latest that AmBase should have brought its claim was 1998.

B. Indemnity Claim

AmBase also seeks its legal fees and expenses under a theory of indemnification. *See* Compl., ¶¶ 40-42. Since accrual of an indemnity claim "occurs upon payment by the party seeking indemnity," *McDermott v. City of New York,* 50 N.Y.2d 211, 428 N.Y.S.2d 643, 646, 406 N.E.2d 460 (Ct. App. 1980), AmBase asserts that its indemnity claim did not accrue until May 2001, when there was a final determination by the Tax Court.

AmBase's claim that the Trust was liable for defending the tax litigation rests on its interpretation that the Assignment Agreement does not burden it with "withholding taxes;" nothing in the Agreement contemplates that

AmBase would assume liabilities to be reimbursed by the Trust in the future. The Assignment Agreement does not envision that AmBase would defend against claims by the IRS and be reimbursed later. Rather, the Agreement stated that AmBase would assume certain tax liabilities of City Investing. As Chancellor Strine stated (Strine Ruling, at 2-3):

> This is not a case of sort of secondary indemnification, where someone has a contract in which they are primarily liable and they know that some other corporation or some other source is secondarily liable and where there is no expectation that the party that is secondarily liable will do anything until a liability really arises. That is not this kind of case. This wasn't a situation where AmBase was expected to defend this for 20-some odd years and then be able to just turn around at the time of a judgment and say to the liquidating trust, "Now you pay the judgment."

Thus, there is no basis for a contractual claim of indemnity arising in May 2001 when the tax litigation became final. Any claim to indemnity arises, not under the Assignment Agreement, but solely because it is imposed or implied by the law: in other words, by the unjust enrichment equitable claims dismissed above.

C. Breach of Fiduciary Duty Claim

AmBase alleges that the individual defendant-trustees should have informed AmBase that the Trust, rather than AmBase, was responsible for the legal fees and expenses of defending against the IRS claims. It claims that, as officers and directors of AmBase, they breached duties of "loyalty,

care and good faith" beginning when "the withholding tax dispute with the IRS arose in the mid-1980s." Compl ., ¶ 15.

Under C.P.L.R. § 213(7), a claim by a corporation against a present or former director or officer, like a breach of contract claim, accrues "upon breach, rather than plaintiff's discovery of the breach." *Whitney Holdings, Ltd. v. Givotovsky,* 988 F. Supp. 732, 743 (S.D.N.Y. 1997).

AmBase asserts that its claim accrued in 1996 when Mantell left AmBase because the trustee-defendants continually breached their fiduciary duties up until that time. The complaint, however, does not allege fresh breaches that occurred after the original breach in the "mid-1980s" when the trustee-defendants "endeavored to foist such alleged withholding tax liability upon AmBase." Compl., ¶ 17. The fact that the trustee-defendants remained officers and directors of AmBase does not mean that their alleged breaches reoccurred over and over again until Mantell left in 1996. *Cf. Korn v. Merrill,* 403 F. Supp. 377, 388 (S.D.N.Y. 1975) (holding that defendant investment advisor's continued receipts of fees from plaintiff after it made fraudulent representations to the plaintiff were not "a series of independent and continuing injuries" which could extend the statute of limitations, but merely elements of plaintiff's damages); *Lowell Wiper Supply Co. v. The Helen Shop, Inc.,* 235 F. Supp. 640, 644 (S.D.N.Y. 1964) (continual excessive rental payments on renewal leases, allegedly entered into due to defendant fiduciary's fraud, did not give "rise to a separate and distinct cause of action. . . . ")

Like AmBase's other claims, the breach of fiduciary duty claim accrued in 1986, and is barred under the six-year statute of limitations and the two year discovery rule.[3]

D. Professional Negligence and Malpractice Claim

AmBase alleges that Mantell, "AmBase's professional tax advisor," committed malpractice by failing "to provide competent and reliable advice on matters regarding AmBase's tax or tax-related liabilities." Compl., ¶ 50.

AmBase does not dispute that the statute of limitations for professional negligence and malpractice is three years under C.P.L.R. § 214(6), *see* Pl. Memo dated March 9, 2001, at 23, and it is dismissed.

CONCLUSION

The defendants' motion to dismiss based on the statute of limitations is granted. The Clerk shall dismiss the complaint.

So ordered.

DATED: New York, New York

January 11, 2002

LOUIS L. STANTON

U.S.D.J.

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[3] The claims against Pyne and Schaffenberger, two of the trustees, are barred even under plaintiff's continuing wrong theory because they left AmBase in 1993, more than six years before AmBase brought suit.

Ambase Corporation v. City Investing Company, et al
C.A. No. 18207

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

2001 Del. Ch. LEXIS 16

February 7, 2001, Decided

COUNSEL: P. Clarkson Collins, Jr., Esquire, Morris, James, Hitchens & Williams, Wilmington, DE.

Kenneth J. Nachbar, Esquire, Morris, Nichols, Arsht & Tunnell, Wilmington, DE.

JUDGES: LEO E. STRINE, JR., VICE-CHANCELLOR.

OPINION BY: Leo E. Strine, Jr.

OPINION: Plaintiff Ambase Corporation has moved for reargument of my December 14, 2000 bench decision dismissing its claim against City Investing Liquidating Trust (the "Trust") and certain Trust affiliates on statute of limitations and laches grounds. That bench opinion was implemented by a final order on January 3, 2001.

To prevail on its reargument motion, Ambase must demonstrate that the court's prior decision "rested on a misunderstanding of a material fact or a misapplication of law."[1] "The court's focus on a motion under Rule 59(f) is solely on the facts in the record at the time of the decision."[2]

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[1] *Arnold v. Society for Savings Bancorp,* Del. Ch., C.A. No. 12883, 1995 Del. Ch. LEXIS 106, at *1, Chandler, V.C. (Nov. 5, 1990).

[2] *Price v. The Continental Insurance Co.,* 2000 Del. Ch. LEXIS 85, Del. Ch., C.A. No. 17219-NC, letter op. at 2, Lamb, V.C. (Mar. 3, 2000)

(Continued on following page)

In its motion, Ambase contends that the court misapprehended the law and the facts in dismissing its claims as time-barred. But its argument is premised on a misreading of the court's decision. The court's earlier decision relied upon undisputed facts and a view of the law the court continues to believe is correct. Moreover, Ambase relies upon a great deal of evidence that it failed to present during the earlier briefing. Ambase also raises new arguments. Neither the new evidence nor the new arguments are properly raised at this time. As a result, the court will deny Ambase's motion.

Factual Background

A brief recitation of the basic dispute will suffice. The underlying facts are drawn from Ambase's complaint. In 1975, City Investing Company ("City") formed a wholly-owned subsidiary called The Home Group, Inc., which is now the plaintiff Ambase. For simplicity's sake, I refer to The Home Group as Ambase.

In 1985, City engaged in a transaction whereby it distributed out its assets and liabilities. For purposes of this opinion, what is important is that City distributed its shares of Ambase out to City stockholders. City stockholders also received units in the Trust, which was also formed at that time and was responsible for all liabilities of City that were not otherwise provided for.

(*citing Miles, Inc. v. Cookson America, Inc.*, Del. Ch., 677 A.2d 505, 506 (1995)).

Put simply, the owners of City divided the assets and liabilities they solely possessed between two different entities. Pursuant to an August, 1985 Assignment Agreement, Ambase assumed certain liabilities of City. These included all "obligations of City for Federal income taxes (including all interest and penalties thereon) as common parent of the City Affiliated Group . . . "

When the Trust was created and Ambase was spun off, certain directors and officers of City (the "Trustee Defendants") occupied positions with both entities:

. Defendant George Scharffenberger has been a Trustee of the Trust since its creation, and served as Chairman of the Ambase board until January 24, 1993. Scharffenberger had been City's Chief Executive Officer at the time of the Assignment Agreement. Scharffenberger left Ambase seven and a half years before Ambase filed its complaint in this action.

. Defendant Eben Pyne has been a Trustee of the Trust since its creation, and was a member of the Ambase board until January 24, 1993. Pyne left Ambase seven and a half years before the complaint in this action was filed by Ambase.

. Defendant Lester J. Mantell has served as a Trustee of the Trust since its creation. Mantell had been a senior City officer before the Ambase spin-off, and served in high ranking positions at Ambase until his departure in December 1996. At Ambase, Mantell had significant responsibility for Ambase's handling of tax matters. Mantell left Ambase over three and a half years before its complaint in this action was filed.

In March 1986, the Internal Revenue Service (the "IRS") issued a Revenue Agent's Report contending that City had failed to properly withhold taxes for years 1979 and 1980 relating to the affairs of its Netherlands Antilles subsidiary. The IRS later extended that claim to years 1981 to 1985. The amount of the withholding at issue is nearly $21 million. As of March 1986, the accrued interest on that sum was around $10 million.

The Revenue Report was addressed to Ambase as City's agent under the Assignment Agreement. Ambase responded as if any liability owed by City was its responsibility under the Assignment Agreement. At that time, it is alleged that Mantell was Ambase's senior tax advisor and guided Ambase policy on the matter.

In 1986, Ambase did not pay the taxes alleged to be owed. If it had done so, the running of further interest would have been cut off. Moreover, if Ambase ultimately proved that the taxes were not owed, Ambase would have received interest to compensate it for the loss of the time-value of its money. Ambase also did not demand that the Trust pay the taxes allegedly owing, nor did it demand that the Trust assume the defense against the IRS.

Nine years then passed during which Ambase acted as if the potential tax liability was its responsibility.

On May 11, 1995, the IRS issued a Notice of Deficiency to Ambase claiming entitlement to the funds that it alleged should have been withheld. As of that time, defendants Scharffenberger and Pyne had left their positions at Ambase; defendant Mantell was still an officer there. Thus, as of the time Ambase received the Notice of Deficiency, the Ambase board had no members who were Trustees.

On June 29, 1995, Ambase filed a petition with the U.S. Tax Court on behalf of City contesting the alleged tax liability. As of 1995, the accrued interest on the withholding obligation of $21 million had risen to $61 million, for a total liability of over $80 million. Ambase did not seek to bring the Trust into the case or to sue the Trust.

As noted, defendant Mantell left Ambase's employment in December 1996.

1997 passed without Ambase claiming that the Trust, and not Ambase, was primarily responsible for the withholding tax.

1998 also passed without Ambase claiming that the Trust and not Ambase was primarily responsible for the withholding tax.

1999 passed without Ambase claiming that the Trust and not Ambase was primarily responsible for the withholding tax obligation.

The first seven and a half months of 2000 passed without Ambase claiming that the Trust and not Ambase was primarily responsible for the withholding tax obligation.

On August 14, 2000, Ambase filed its complaint for declaratory and injunctive relief in this court. At that time, Ambase for the first time contended that the potential withholding tax obligation that it had been apprised of for fourteen years was not its primary responsibility under the Assignment Agreement. Ambase sought a preliminary injunction preventing the Trust from making distributions that would endanger the Trust's ability to pay the withholding tax liability, which had by then grown to $141 million. The complaint also sought a recovery of Ambase's

expenses in dealing with the IRS since 1986, an amount equal to over $3 million.

The basis for the complaint was that the withholding tax liability of City for its Netherlands Antilles subsidiary was not assigned to Ambase under the Assignment Agreement as a primary liability of Ambase. Rather, that liability was primarily the Trust's, which had a duty to step up to the plate by defending against the IRS's claim and paying the liability if it ultimately was proved to be owed.

By the time the complaint was filed, the Trust had remaining assets of around $73 million, or slightly more than half of the potential withholding tax liability. The Trust had been funded with assets of between $150 million and $225 million. Between 1985 and 1990, the Trust had distributed over $280 million to former City stockholders who held Trust units. By 2000, the Trust was poised to make its final distributions and close down, if it could address certain environmental liabilities.

The Court's Prior Opinion

The Court's prior opinion was buttressed by the facts just articulated, all of which emerge from Ambase's own complaint. In that oral opinion, I concluded that Ambase's complaint was barred by the statute of limitations because the suit should have been brought at the latest no later than three years after Mantell's departure from his employment at Ambase.

At that time, I reasoned that Ambase could have brought this action against the Trust as early as 1986,

when the Revenue Report was issued, and certainly by 1995, when the Notice of Deficiency was issued.

These IRS documents quantified a specific liability that was allegedly owed as a result of City's withholding failures. Not only that, the liability was fixed in a manner that could be addressed in a financially and legally important manner. If the liability was paid subject to a contest, the liability was not subject to further interest payments and the payor was protected because interest would accrue to it if it prevailed against the IRS in the end.

Under Ambase's own theory, the Trust was the entity that had to address this liability. Because Ambase could be injured by the Trust's failure to satisfy the liability and cut off the running of interest or, alternatively, to set aside funds sufficient to pay the entire liability, it could have sued the Trust for failing to accept its contractual responsibilities. This failure obviously could compromise Ambase, which might be forced to bear the whole liability if the Trust distributed its assets and did not provide for an obligation primarily assigned to it, and not Ambase.

Furthermore, as Ambase's claims for reimbursement for its expenses back to 1986 demonstrates, Ambase had a litigable dispute with the Trust over which entity should have to deal with the IRS. If the Assignment Agreement did not assign the potential liability primarily to Ambase, it was the Trust's duty to defend the claim and Ambase would only be exposed if the Trust lost and was unable to make the government whole.

In sum, Ambase's claims that the Trust is primarily responsible for the potential withholding tax liability, that it should be required to set aside assets sufficient to satisfy that liability, and that it and not Ambase should

bear the cost of contesting the liability were surely ripe as of 1995, if not in 1986.[3] These claims could also have been explicitly framed as breaches of the Trust's obligations under the Assignment Agreement;[4] they are in fact pled implicitly as such now.

Another foundational element of my prior decision was that there was no reason not to hold Ambase to the relevant statute of limitations, even though this case is brought in equity.[5] Because Ambase's injunctive and declaratory relief claims are based on a breach of contract theory and the complaint was not filed until August 2000, I held that the operation of the three year statute of limitations[6] barred its claim unless some basis for equitable tolling of the statute existed.

"Equitable tolling occurs when the plaintiff can show that it was ignorant of the wrong due to the defendant's fraud or fraudulent concealment or some other circumstance justifying why plaintiff did not have reason to know of the facts constituting the alleged wrong."[7] Ambase argued that the statute had been equitably tolled because

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[3] *Keller v. President, Directors & Co. Of Farmers Bank*, Del. Super., 41 Del. 471, 24 A.2d 539, 541 (1942) ("Statutes of Limitation begin to run when proper parties are in existence capable of suing and being sued, and a cause of action exists capable of being sued on forthwith.").

[4] *Nardo v. Guido DeAscanis & Sons, Inc.*, Del. Super., 254 A.2d 254, 256 (1969) (cause of action accrues at time contract is breached).

[5] *See Kahn v. Seaboard Corp.*, Del. Ch., 625 A.2d 269, 277 (1993).

[6] *See* 10 Del. C. § 8106.

[7] *Cincinnati Bell Cellular Systems Co. v. Ameritech Mobile Phone Service of Cincinnati, Inc.*, 1996 Del. Ch. LEXIS 116, *46-47, Del. Ch., C.A. No. 13389, Chandler, V.C. (Sept. 3, 1996) (*citing Kahn*, 625 A.2d at 276).

the Trustee Defendants held offices at both Ambase and the Trust after the Assignment Agreement. Rather oddly, Ambase pled the case as one involving dark motivations, even though the Assignment Agreement itself arises out of the least suspicious of circumstances.[8]

It must be remembered that City was dividing itself in 1985. While the division was obviously structured to be as advantageous as possible to City stockholders, it is paradoxical to think that the City board could structure the division in a way that would be unfair to the City stockholders. After all, those stockholders were the ultimate owners of all of City's assets and liabilities, both before and after the division. City was simply splitting up its own pie.

The fact that the Trustee Defendants thereafter served both as Trustees and as Ambase directors and/or officers thus emerges as benign and to be expected. To buttress its equitable tolling argument, however, Ambase insinuated, without factual support, that the Trustee Defendants had a motive to favor the Trust over Ambase. Therefore, the Trustee Defendants supposedly influenced Ambase to accept liability for the withholding tax liability. But Ambase did not plead or assert facts that suggested that the Trustee Defendants owned a sufficient number of

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[8] In its reargument motion, Ambase continues its odd approach. For example, it argues that it was somehow unseemly for the Trustee Defendants to want the Trust to pay out distributions to the unitholders. Why? Wasn't the Trust created to benefit the City stockholders, all of whom also became Ambase stockholders when the Trust was created? The fact that time has undoubtedly changed the Ambase stockholder base does not erase the fact that the Trust was not conceived in suspicious circumstances.

units in the Trust to make it materially beneficial to them to favor the Trust over Ambase, which was the source of Scharffenberger's and Mantell's livelihood until 1993 and 1996 respectively.

In my oral opinion, I noted how thin Ambase's equitable tolling argument seemed to be. While I did not dilate on the point then, it remains apparent that the argument that the Trustee Defendants fraudulently concealed[9] the basis for Ambase's claims or that the claims were inherently undiscoverable before all of them departed Ambase lacks strength.

As my oral decision noted, Ambase does not plead that the Ambase board was ever comprised of a majority with Trust affiliations. To the contrary, Ambase's counsel admitted at argument that since 1985, Ambase's board has always been comprised of a majority without affiliations with the Trust.

It is not plausible that this Ambase board majority lacked knowledge of the Trustee Defendants' positions with the Trust. If the Ambase board majority blindly relied upon the Trustee Defendants' advice as to which entity was primarily responsible for the disputed tax liability, the board majority did so with knowledge of the Trustee Defendants' affiliations with the Trust – and thus at its own peril. Likewise, the Ambase board surely knew or had

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[9] The complaint does not plead such fraud with particularity nor do Ambase's submissions articulate the supposed fraudulent acts with particularity. It must also be remembered that the basis for Ambase's claims is the Assignment Agreement; those claims are not based on any breach of fiduciary duty allegedly committed by the Trustee Defendants in connection with the execution of the Assignment Agreement.

reason to know that the Trustee Defendants might hold Trust units; after all, all the City stockholders received Ambase shares and Trust units in the division. Therefore, the Ambase board had every reason to seek another opinion on the matter, from sources unconnected to the Trust.

Adding to the weakness of Ambase's equitable tolling argument was the obvious difficulty of concealing claims that Ambase now alleges can be wholly supported by the language of the Assignment Agreement and the IRS Code. While the tax issues are complex and Mantell was obviously an important player on tax matters at Ambase, the withholding tax liability is a large one. Neither the Assignment Agreement nor the IRS Code are secret documents. There is no reason that a diligent Ambase board would not have looked into the issue or sought a view from sources other than the Trustee Defendants.[10] It was simply not a practical impossibility[11] for Ambase to discover a breach of a contract it had in its own possession.

In view of these factors, the notion that the statute of limitations was tolled as to Ambase during the time Trustee Defendants served the company seemed to me to be quite weak. But, in the end, I did not rest my dismissal

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[10] *In re Dean Witter Partnership Litig.*, 1998 Del. Ch. LEXIS 133, *21 Del. Ch., Cons. C.A. No. 14816, Chandler, C. (July 17, 1998) (fraudulent concealment "requires an affirmative act of concealment by a defendant" and even when proven, the statute is only tolled until the plaintiff's claims "could have been discovered by the exercise of reasonable diligence").

[11] *Dean Witter*, 1998 Del. Ch. LEXIS 133, *19 (inherently unknowable exception requires proof that injury's discovery was practically impossible).

decision on a holding that the statute of limitations began to run before the last of the Trustee Defendants had left Ambase.

Instead, I noted the undisputed fact that all of the Trustee defendants had left Ambase's service by December 1996. Thus, any influence the Trustee Defendants had over Ambase was gone as of that point.

Given that the Assignment Agreement was fully available to Ambase, as was the IRS Code, there was no reason why Ambase could not have asserted its claim within three years after Mantell's December 1996 departure.[12] Ambase had full notice of the fact that the Assignment Agreement was the basis for it assuming primary liability for City's withholding tax liability. Ambase thus had the information to decide whether to assert a claim. All its board or management had to do was instruct someone to read the contract and the IRS Code.

Tellingly, Ambase could never identify when the spell cast over its decision-making processes by the Trustee-Defendants would end and the running of the statute of limitations would begin again. Apparently, the claims could have been brought two, five, ten years, or twenty-five years later than they were. How the claims were miraculously discovered in the summer of 2000 given the supposed impossibility of their discovery was not clear.

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[12] *Dean Witter*, 1998 Del. Ch. LEXIS 133, *19-20 (plaintiff invoking equitable tolling doctrines must show that it could not have brought claims if it acted diligently).

Given all these circumstances, I held that Ambase's argument that the statute of limitations was equitably tolled beyond December 1996 to be without merit. Equitable tolling doctrines are an exception to the normal rule, and should not be lightly invoked. When a party has reason and the capacity to assert claims in a timely manner it must do so. When the circumstances that give rise to equitable tolling dissipate, the party which had the benefit of more time is expected to act diligently thereafter.

As Chancellor Chandler has noted:

> [The statute] is tolled only until the plaintiff discovers (or exercising reasonable diligence should have discovered) his injury. Thus, the limitations period begins to run when the plaintiff is objectively aware of the facts giving rise to the wrong, i.e., on inquiry notice.[13]

Consistent with these principles, I held that no later than December 1996 Ambase was on full inquiry notice and possessed all the knowledge it needed to bring its claim.

That reasoning was the primary basis for my dismissal order. In the alternative, I held that the doctrine of laches also barred Ambase's claim. I based that alternative holding on the facts pled in the complaint, and concluded that those facts demonstrated that the requisite elements of laches existed.[14] Ambase had reason to know of its claims for quite a long time, but did not assert them until

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[13] *Dean Witter,* 1998 Del. Ch. LEXIS 133, *23 (emphasis in original).

[14] *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.,* Del. Ch., 714 A.2d 96, 104 (1998) (setting forth the test for laches).

August 2000. During the long delay that had transpired since the withholding tax liability first emerged in 1986, the Trust had taken actions in reliance upon the undisputed fact that Ambase had acted as if it was primarily liable for the disputed tax. In particular, the Trust had distributed out assets that could have been used to satisfy the liability. It now has fewer dollars than are needed to satisfy the withholding claim alone, leaving it with no resources to address the other pending claims mentioned in the complaint.

Ambase's course of conduct also prejudiced the Trust in another way. Because payment of the liability could have cut off the running of interest at any time, the Trust could have limited its risk by doing just that. Because Ambase did not raise its claim until the year 2000, the Trust had no earlier chance to do so.

Ambase's Reargument Motion

Ambase's reargument motion is based on a misapprehension of my prior decision. In particular, Ambase claims that I dismissed its claims because Ambase had not convinced me that equitable tolling had stopped the running of the statute of limitations before Mantell's departure in December 1996. It therefore believes that I erred by relying upon contested factual issues regarding the motivations of the Trustee Defendants.

But that was not the linchpin of my statute of limitations decision. I took a far more conservative approach. I held that it was clear that Ambase's claims were ripe as of December 1996, that any influence of the Trustee Defendants was gone as of that time, that Ambase possessed all

the knowledge it needed to file suit within three years of that time, and that it did not do so.

In its reargument motion, Ambase does not quibble with the facts that support my prior decision. Rather, they argue that Ambase was entitled to rely blindly and indefinitely on what the Trustee Defendants had said about which entity bore the withholding tax liability. That is, regardless of the fact that Ambase's claims arise from the face of a contract that it has possessed since 1985 and its reading of the IRS Code, the statute of limitations was forever tolled. I continue to believe that not to be the law, and to disagree with the proposition that claims based on the language of a contract and a code book are inherently undiscoverable by a public company, with a board of directors, officers, employees, and potential derivative plaintiffs to help it sniff out litigable injuries.

Ambase's motion also attaches an array of documentary evidence that Ambase did not file in its papers answering the dismissal motion. This new evidence is not properly raised at this late juncture.

My refusal to consider this evidence does not work any procedural unfairness upon Ambase. Ambase could have submitted this newly asserted evidence in response to the defendants' dismissal motion. Ambase also could have attempted to justify the need for discovery at that time. It did not do so and its arguments in that regard now come too late. Most important, the court's dismissal motion is buttressed by facts that Ambase even now does not dispute.

Finally, Ambase raises a host of other new arguments in its papers, which it did not raise in briefing on the dismissal motion and which are therefore not properly

made on a reargument motion. For example, it spins a new yarn about the substantial motivations that Mantell had to cover up the Trust's possibility liability for the withholding tax liability. The new theory in large part reduces to the assertion that it made little business sense for City to allocate the withholding tax liability to the Trust rather than to Ambase, and that Mantell faced exposure to the Trust for his alleged failure to make sure that the liability was allocated to Ambase in the Assignment Agreement.[15]

Putting aside the many reasons that this theory seems improbable,[16] the theory does not explain the over three and a half year delay that followed Mantell's departure from Ambase. Again, it bears emphasis that the supposed motivations that Mantell harbored to favor the Trust were known by Ambase's other directors and officers since 1985. Ambase's argument thus reduces to its assertion that Mantell had placed some Svengali-like spell on Ambase's board that did not wear off until more than three years after he left.

All of Ambase's other arguments rest on this same foundation. Because the Ambase board chose to rely on Mantell with full knowledge of his Trust affiliations, Ambase contends that it had until the end of the universe

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[15] The reader should remember that it is the defendants' position that the Assignment Agreement did in fact make Ambase primarily liable for the withholding tax liability. Ambase's assertion that assignment of the disputed liability to the Trust was at least counter-intuitive from a business perspective has the unintended effect of supporting defendants' argument on the merits.

[16] The improbability of the theory is well articulated in the defendants' answer to Ambase's reargument motion.

to file this suit. I continue to reject this view that corporations and their directors have no obligation to act in a commercially diligent manner in discovering and asserting claims.

Conclusion

For the foregoing reasons, Ambase's motion for reargument is denied. IT IS SO ORDERED.

Leo E. Strine, Jr.

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

AMBASE CORPORATION, a Delaware corporation, Plaintiff, v. CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, and GEORGE T. SCHARFFENBERGER, EBEN W. PYNE and LESTER J. MANTELL, as Trustee of CITY INVESTING COMPANY LIQUIDATING TRUST, Defendants.	)	C.A. No. 18207-NC

ORDER

(Filed Jan. 4, 2001)

WHEREAS, plaintiff filed this case on August 14, 2000, and

WHEREAS, defendants moved to dismiss the Complaint on September 29, 2000, on the grounds that (i) the causes of action alleged in the Complaint are barred by the statute of limitations and (ii) the Complaint fails to state a claim upon which relief may be granted; and

WHEREAS, the Court has considered the briefs and arguments of the parties,

IT IS HEREBY ORDERED this 3rd day of January, 2001, that the Complaint in this action is hereby dismissed with prejudice, solely on the grounds that it is barred by the statute of limitations and the doctrine of laches, as set forth more fully in Court's oral ruling of December 14, 2000, attached hereto as Exhibit A, the Court not having ruled on the merits of the underlying substantive claims.

/s/ Leo E. Strine, Jr.
Vice Chancellor

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

ROSEANN B. MACKECHNIE
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 12th day of June two thousand three.

AMBASE CORPORATION, A Delaware Corporation,

dkt #: 02-7230

Plaintiff-Appellant,

v.

CITY INVESTING COMPANY LIQUIDATING TRUST, as successor to City Investing Company, a dissolved Delaware Corporation, JOHN J. QUIRK, Trustee of City Investing Company Liquidating Trust, and MARION SCHARFFENBERGER, Executrix of the Estate of George T. Scharffenberger, EBEN W. PYNE, Individually and as Trustee of the City Investing Company Liquidating Trust, LESTER J. MANTELL, Individually and as Trustee of the City Investing Company Liquidating Trust,

Defendants-Appellees.

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant AmBase Corporation.

> Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

ROSEANN B. MACKECHNIE,
Clerk

By: /s/ Arthur Heller
Arthur M. Heller,
Motions Staff Attorney

U.S. Constitution

Article IV

Section 1. Full faith and credit shall be given in each state to the public acts, record, and judicial proceedings of every other state. And the Congress may by general laws prescribe the manner in which such acts, records, and proceedings shall be proved, and the effect thereof.

Amendment V

No person shall . . . be deprived of life, liberty, or property, without due process of law.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

AMBASE CORPORATION, a Delaware Corporation, Plaintiff, -against- CITY INVESTING COMPANY LIQUIDATING TRUST, as Successor to CITY INVESTING COMPANY, a dissolved Delaware corporation, and GEORGE T. SCHARFFENBERGER, FEBEN W. PYNE and LESTER J. MANTELL, Individually and as Trustees of the CITY INVESTING COMPANY LIQUIDATING TRUST, Defendants.	01 Civ. 0771 (LLS)

REPLY MEMORANDUM IN SUPPORT OF DEFENDANT'S MOTION TO DISMISS PURSUANT TO FED. R. CIV. P. 12(b)(6)

Introduction

In its most recent brief (its fourth on the subject),[1] AmBase Corporation ("AmBase") misrepresents City Investing Company Liquidating Trust's (the "Trust")

[1] AmBase's first brief on this subject was filed on November 15, 2000 in opposition to the Trust's motion to dismiss the Delaware action. AmBase again raised the same issues in its motion for reargument in Delaware, filed January 10, 2001. AmBase next raised these issues on March 9, 2001, in its brief in response to the Trust's motion to dismiss this case. AmBase's latest brief was filed on November 26, 2001.

position, the law of Delaware, Vice-Chancellor Strine's opinion, the law of New York, an Administration Agreement which does not even mention AmBase's assumption of the

* * *

ARGUMENT

I. THE FACTUAL AND LEGAL FINDINGS OF THE DELAWARE COURT ARE ENTITLED TO PRECLUSIVE EFFECT IN THIS COURT.

The main point of AmBase's latest brief is that Vice-Chancellor Strine's findings are not entitled to preclusive effect under Delaware (and, therefore, New York) law because the Delaware case was dismissed on statute of limitations grounds and not "on the merits". AmBase's argument misstates the Trust's legal position, conflates the two separate and distinct doctrines of res judicata (or claim preclusion) and collateral estoppel (or issue preclusion), and misrepresents Delaware law.

The Trust has never raised res judicata, or claim preclusion, as a basis for dismissal of this case. Instead, the Trust has consistently maintained that the findings which the Vice Chancellor made in his ruling should be given issue preclusive effect.

"Collateral estoppel and res judicata are related but distinct doctrines that may bar a party from litigating certain issues or claims in a subsequent proceeding." Epperson v. Entm't Express, Inc., 242 F.3d 100, 108 (2d Cir. 2001). Under the doctrine of res judicata, or claim preclusion, "a final judgment on the merits of an action precludes the parties or their privies from relitigating

issues that were or could have been raised in that action." Leather v. Ten Ryck, 180 F.3d 420, 424 (2d Cir. 1999). In contrast, collateral estoppel "precludes a party from relitigating in a subsequent action or proceeding an issue clearly raised and decided against that party . . . whether or not the tribunals or causes of action are the same." Id. at 425.

Claim preclusion is ordinarily created by a judgment on the merits. However, it is black-letter law that a question of fact actually litigated and resolved in a prior proceeding is entitled to collateral estoppel effect – even if the prior case is dismissed on statute of limitations grounds. The Delaware Supreme Court has explicitly recognized the difference between res judicata and collateral estoppel, and has given preclusive effect to findings of fact even though the previous court did not adjudicate plaintiff's claims on the merits. See Stephenson v. Capano Dev., Inc., 462 A.2d 1069, 1073 (Del. 1983); Winkler v. Balentine, 254 A.2d 849, 851 (Del. 1969).

AmBase mistakenly claims that the Delaware cases it cites, Cappello v. Patrician Towers, Inc., No. 102, 1981 Del. LEXIS 272 (Del. Jan. 14, 1981) and Equity Corporation v. Groves, 53 A.2d 505 (Del. Ch. 1947), stand for the proposition that Delaware courts do not give issue preclusive effect to judicial findings of previously litigated facts if the prior case was dismissed on statute of limitations grounds. (AmBase Br. at 17). In fact, the Cappello case dealt only with claim preclusion, and not with collateral estoppel. The court in Cappello held "that a judgment based on the forum's statute of limitations is not a ruling on the merits and is not, therefore, entitled to res judicata effect in a later action in another jurisdiction." Cappello, 1981 Del. LEXIS 1980, at *2-3 (emphasis added). By

cutting off its quote of the court's opinion to eliminate the words "res judicata" and inserting its own phrase: "any preclusive effect", AmBase misrepresents the holding of the case.

In Cappello, the plaintiff had previously brought identical claims in Virginia, which were dismissed because they were not brought within Virginia's three-year statute of limitations. The Cappello court unsurprisingly held that the prior ruling that the claims were time-barred under Virginia law did not have the res judicata effect of determining that those claims were time-barred under Delaware law. The court made clear, however, that its ruling was only that the Delaware trial court should not have accorded res judicata effect "to that aspect of the Virginia judgment." Cappello, 1981 Del. LEXIS, at *3.

Neither Cappello nor Equity Corp. in any way suggested that previously-litigated questions of fact or law actually adjudicated by the prior tribunal were not entitled to collateral estoppel effect.

The Trust has never argued that res judicata bars AmBase from bringing a claim in New York because that claim was previously dismissed in Delaware on statute of limitations grounds. The Trust's position is only that the Delaware court's factual findings are entitled to issue preclusive effect in this Court. Applying New York law to those previously adjudicated facts requires the dismissal of AmBase's claims because they are time-barred under New York law.

Vice Chancellor Strine made at least four findings that are entitled to preclusive effect: (1) AmBase's claims against the Trust accrued in 1986 (Strine Op. 8-9; Strine Oral Op. 4); (2) AmBase was on full inquiry notice of the

existence of these claims no later than December 1996 (Strine Op. 14-16; Strine Oral Op. 5); (3) AmBase's alleged reliance on the Trustee defendants in connection with the Income Tax Liability was unreasonable as a matter of law, and could not support equitable tolling of the statute of limitations (Strine Op. 10-14; Strine Oral Op. 4-5); and (4) AmBase's claims are barred by the doctrine of laches (Strine Op. 16-17; Strine Oral Op. 6-7).

New York law clearly grants preclusive effect to factual determinations even when "the issue precluded was the subject of only an alternative determination by the trial court." Malloy v. Trombley, 50 N.Y.2d 46, 52, 405 N.E.2d 213, 216 (1980). Seeking to avoid the thrust of these cases, AmBase makes the untenable claim that Malloy does not apply "where the preclusive effect of the prior proceeding is determined pursuant to Delaware law." (AmBase Br. at 23) AmBase's baseless claim that the "alternative determination" doctrine is applicable only where the previous adjudication applied New York law finds no support in principle or precedent. AmBase also derides The Trust's "unique and creative application of New York's 'alternative determination' theory to the collateral estoppel doctrine." (AmBase Br. at 22). In fact, the New York doctrine of "alternative determinations" is clearly applicable to collateral estoppel cases. See Malloy v. Trombley, 50 N.Y.2d 46, 52, 405 N.E.2d 213, 216 (1980); Aldrich v. State, 110 A.D.2d 331, 332, 494 N.Y.S.2d 662, 663 (1985).

Finally, AmBase's counsel have not argued that standards under New York law differ from standards under Delaware law in any way which would undermine Vice-Chancellor Strine's findings, nor could they. Vice-Chancellor Strine's findings that AmBase's claims accrued

as early as 1986, that AmBase was on full inquiry notice of its claims not later than December 1996, that AmBase's alleged reliance on the trustees was unreasonable, and that AmBase's claims are barred by laches could have as easily been found by a Justice of the New York State Supreme Court, or this Court.

* * *

United States Court of Appeals
For the Second Circuit

August Term, 2002

(Argued: November 7, 2002 Decided: April 3, 2003)

Docket No. 02-7230

AMBASE CORPORATION, A Delaware Corporation,

Plaintiff-Appellant,

-v.-

CITY INVESTING COMPANY LIQUIDATING TRUST, as successor to City Investing Company, a dissolved Delaware Corporation, JOHN J. QUIRK, Trustee of City Investing Company Liquidating Trust, and MARION SCHARFFENBERGER, Executrix of the Estate of George T. Scharffenberger, EBEN W. PYNE, Individually and as Trustee of the City Investing Company Liquidating Trust, LESTER J. MANTELL, Individually and as Trustee of the City Investing Company Liquidating Trust,

Defendants-Appellees.

Before: WALKER, Chief Judge, and OAKES and MINER, Circuit Judges.

Appeal from judgment entered in the United States District Court for the Southern District of New York (Stanton, J.), dismissing on the pleadings plaintiff-appellant's action for indemnification of legal expenses and denying plaintiff-appellant leave to amend its complaint upon finding that both the causes of action pleaded in the original complaint and those pleaded in the proposed amended complaint were either time barred under

New York's statute of limitations or failed to state claims upon which relief could be granted.

Affirmed.

* * *

DISCUSSION

I. Standard of Review

A complaint should not be dismissed pursuant to Fed. R. Civ. P. 12(b)(6) for failure to state a claim upon which relief can be granted "'unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" Cooper v. Parsky, 140 F.3d 433, 440 (2d Cir. 1998) (quoting Conley v. Gibson, 355 U.S. 41, 45-46 (1957)). A court's task "in ruling on a Rule 12(b)(6) motion 'is merely to assess the legal feasibility of the complaint, not to assay the weight of the evidence which might be offered in support thereof.'" Cooper, 140 F.3d at 440 (quoting Ryder Energy Distribution Corp. v. Merrill Lynch Commodities Inc., 748 F.2d 774, 779 (2d Cir. 1984)). Furthermore, a court must "accept as true all factual allegations in the complaint." Cooper, 140 F.3d at 440. Finally, "we are entitled to affirm . . . on any ground for which there is support in the record, even if not adopted" by the District Court. Adirondack Transit Lines, Inc. v. United Transp. Union, Local 1582, 305 F.3d 82, 88 (2d Cir. 2002). In particular, we can affirm the dismissal of a complaint for failure to state a claim based on the affirmative defense of res judicata if "all relevant facts are shown by the court's own records," of which we can take judicial notice. Day v. Moscow, 955 F.2d 807, 811 (2d Cir. 1992).

II. Res Judicata

Where there is a final state court judgment, a federal court looks to that state's rules of res judicata to determine the preclusive effect of that judgment. Town of Deerfield, N.Y. v. FCC, 992 F.2d 420, 429 (2d Cir. 1993) (citing 28 U.S.C. § 1738). Thus, to determine the preclusive effect of the judgment in the Delaware Action, we must look to the Delaware courts' rules of res judicata. In Delaware, a claim is barred by res judicata if: (1) the court that adjudicated the prior action had jurisdiction to do so; (2) the parties to the subsequent action are the same as (or privies to those in) the prior action; (3) the causes of action in both cases are the same or the subsequent action arises from the same transaction that formed the basis of the prior action; (4) the merits in the prior action were decided adversely to the contentions of the plaintiff; and (5) the prior action was final. Maldonado v. Flynn, 417 A.2d 378, 381 (Del. Ch. 1980). Here, four of these five elements need not detain us long. The Chancery Court plainly had subject matter and personal jurisdiction to adjudicate the Delaware Action. The parties to the Delaware Action were the same as the parties to the case at bar. The dismissal of the Delaware Action was adverse to AmBase and was a dismissal on the merits. See Loving v. Pirelli Cable Corp., 11 F. Supp. 2d 480, 491-92 (D. Del. 1998) (dismissal of action by a Delaware court as time barred by the Delaware statute of limitations is a dismissal on the merits for res judicata purposes), aff'd mem., 178 F.3d 1279 (3d Cir. 1999); Williamson v. Columbia Gas & Elec. Corp., 91 F. Supp. 874, 880 (D. Del.) (same), aff'd, 186 F.2d 464 (3d

Cir. 1950). Finally, the judgment dismissing AmBase's claims in the Delaware Action was final.[9]

The only element to which we must devote further attention concerns whether the causes of action were the same in both cases or whether the instant action arises from the same transaction that formed the basis of the Delaware Action. This "transactional view" of claim preclusion was succinctly explained by the Delaware Chancery Court in Maldonado:

In earlier times the doctrine of res judicata could be invoked only to bar the

* * *

[9] Although on March 8, 2001, AmBase appealed the Chancery Court's decision to the Delaware Supreme Court, AmBase voluntarily dismissed its appeal two weeks later, see AmBase Corp. v. City Inv. Co. Liquidating Trust, No. 106, 2001 (Del.) (Docket Entry Nos. 4-6).